

whitepaper

The Case for Internal Promotions

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The Loss of Leadership

A survey of Corporate Leadership Council members found that approximately three-fourths of companies worldwide are not confident in their capability to effectively staff strategic leadership positions during the next five years (Corporate Leadership Council, 2000). The Bureau of National Affairs (2000) indicates that during the past 10 years, recruiting and hiring have dramatically increased in importance for HR departments. Nearly two-thirds of the surveyed human resource executives consider recruiting and hiring to be one of their top three priorities.

Why Internal Candidates Are Desirable

When filling leadership positions, organizations can select internal candidates or rely on external hires. Both types of candidates offer different benefits for the organization. In light of the growing shortage of leaders, internal candidates are better choices for many reasons. Internal candidates are usually accustomed to the organizational culture, and they have well-developed networks. Before putting someone into a position, organizations can be sure that internal candidates have good motivational fit and do not require extensive orientation. Additionally, internal promotions have the power to be more successful because there is more information available to make accurate decisions. Performance records and examples of past work might provide

enough information to assess future performance. Finally, internal candidates can be guided through a series of customized development experiences that will ensure success in their future positions. Organizations don't have to guess about the quality of internal candidates' past experiences.

Numerous studies support the greater success levels of internal promotions. For example:

- Senior executives fail, in general, 34 percent of the time when hired from the outside and 24 percent when hired from the inside (Kelly-Radford, 2001).
- Organizations who rely on external candidates to fill middle-management positions (more than 25 percent from external sources) have almost double the turnover of organizations who rely on internal promotions (Bernthal & Wellins, 2001).
- In a study of five organizations, 4 to 5 of every 10 executives hired from external sources will fail in their positions (Corporate Leadership Council, 1997 [as cited in Graddick, 1998]).
- Internal promotions have a failure rate of 14 percent, and external hires have a failure rate of 22 percent (Rioux & Bernthal, 1999).
- Collins (2001) studied 11 companies that made the extraordinary transition from good to great performance. They examined the CEOs who led those companies compared to CEOs of organizations that did not make the transition. During the 10 years prior to the "good to great" transition, less than five percent of the CEOs in companies successfully making the transition were considered "outsiders" (one year or less with the company before becoming CEO). In the companies that did not make a successful transition, almost 29 percent of the CEOs were considered outsiders.

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Despite the consistency of these findings, many organizations continue to look outside to find replacements for critical leadership positions that could be filled from inside. There might be times that external candidates would be more appropriate for filling open positions. For example, rapid expansion, the need for fresh perspectives, and the acquisition of new skill sets can all be addressed by external hiring decisions. However, organizations hire external candidates, on average, 13 percent more often than they hire internal candidates even though internal candidates stay in positions and are more successful than external candidates, (Rioux & Bernthal, 1999). Collins' (2001) study of "good to great" organizations revealed that:

"One of the most damaging trends in recent history is the tendency (especially by boards of directors) to select dazzling, celebrity leaders and to deselect potential Level 5 [executive] leaders. I believe that potential Level 5 [executive] leaders exist all around us, if we just know what to look for, and that many people have the potential to evolve into Level 5" (p. 39).

The Challenge

The costs of leader failure can be very high, especially when 4 out of 10 newly promoted managers and executives fail within the first 18 months in their new positions (Manchester International, 2001). The Corporate Leadership Council used a hypothetical example to analyze the cost of derailment and determined that it can be as high as \$275,000, not including indirect costs. Typical costs of derailment include search firm fees, interview and assessment costs, signing bonuses, relocation, training, salary, and severance packages. Additionally, indirect costs from lost productivity and reduced morale can affect other parts of the organization.

The challenge for organizations is to do a better job at both selecting people from outside, when they are needed, and developing people to fill the remaining positions. Going outside is the easy way for organizations. However, as outlined in this research summary, for many positions it is not the best way.

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