NATIONAL DIRECTORS INSTITUTE

# NDI Executive Exchange

# What's on Your Mind?

Share and Discuss the Corporate Governance Issues Impacting Your Business

**Management Development and Succession Planning**

Thursday, November 17, 2011

10:30 a.m. – 11:45 a.m.

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**2011 NDI Executive Exchange Roundtable Panel**
**Management Development and Succession Planning**

*Panelists: Matthew Missad, Andrew Rooke, Pat Daugherty, Carrie Long*

*Time: 10:30 a.m. – 11:45 a.m.*

Brief Introduction of Program and Panelists (Pat)

**I. Panel Discussion**: (30-45 minutes)

A. Role of the Board in CEO Succession Planning

1. How should companies approach the succession planning process? (a) When should the company start the process?; (b) Who should have responsibility for the process?; and (c) What role should the CEO have in choosing a successor?

2. How should companies choose potential CEO candidates? (a) Evaluate the company's future strategic needs; (b) Assess requirements in the areas of strategy, operations, interpersonal relationships and personal qualities; (c) Develop a consensus among board members as to the skills and experiences the CEO will need; and (d) Consider bringing in outside candidates in different positions who could ascend to the CEO role; (e) How many candidates do you need?

3. How should the Board monitor development and readiness of candidates? (a) What methods should Boards' employ to assess potential candidates (e.g. analytical methods, such as 360-surveys from subordinates and peers, emotional traits, reports prepared by candidates, appraisals conducted by independent third party); (b) How important is personal interaction and what kind of interaction should take place between board members and potential candidates; and (c) How often should the board monitor candidate progress (formally or informally)?

4. What can companies do to ease the transition process? (a) Promote a culture that expects and embraces transition at all levels; (b) Consider how long the retiring CEO should remain in a transitional role?; (c) Advantages of no or short transition period; and (d) If the board determines a transition period is necessary, what are some ways to limit the risks.

5. What are the potential models for an emergency succession plan? (a) Mature succession organization: pick a successor candidate earlier than expected; (b) Board agreement on one board member that is ready to assume CEO role if required (e.g. Hewlett Packard – Meg Whitman; GM – Dan Akerson); and (c) Retained executive search firm to attract established, credible industry executive on interim or permanent basis.

B. Management Development

1. What are the characteristics of high-potential future leaders? (a) How do you identify candidates with leadership potential (e.g. value of 360-feedback in evaluation of managers with leadership potential); and (b) What is the importance of having senior management committed to rotating and developing high-potential individuals?

2. Should a company have transparent rating and ranking?

3. How should a company develop high-potential individuals? (a) Encourage participation in management development curriculum, community leadership roles, and service on other boards; and (b) Discuss merits of formal or informal mentoring program.

4. How do you motivate high potential managers? (a) Communicate value through unique reward and recognition system and demonstrate clear path to advancement; and (b) Assignments cultivating managers to "fight above your weight"

**II. Roundtable Discussion –** Small group discussions regarding issues raised above. Record issues discussed by group for final discussion in large group. (30 minutes)

**III. Reconvene Panel –** Each panelist to provide brief overview of points covered in small group. Questions from the audience. (10-15 minutes)

Management

# Best Practices In Succession Planning

Stephen A. Miles and Nathan Bennett 11.09.07, 6:00 AM ET

Over the past two weeks, two iconic companies, Merrill Lynch and Citigroup, have seen their CEOs unexpectedly depart. Equally surprising is the fact that neither company has demonstrated that a strategic approach to succession planning was in place.

Because the board of directors has responsibility for governance, the development and execution of a thoughtful succession-planning process must receive its full consideration. Unfortunately, such efforts are too often underdeveloped, unevenly executed and sometimes simply ignored. When boards permit a happenstance approach to succession planning, they have effectively abdicated one of their most crucial responsibilities.

Our review of succession efforts reveals the four best practices that can be implemented at any company and can help ensure that directors have an effective succession-planning process in place. These practices protect the interests of board members, employees, shareholders and other constituents, and also give everyone confidence in the company's long-term prospects.

**1. Analysis**

The first practice involves developing a solid understanding of the most significant challenges the company and its industry are likely to face over the next four to six years, and the skills and experiences the chief executive will need to lead the company past those hurdles. Directors must fight the tendency to think the answer is to find a younger version of the incumbent CEO.

Only in the rarest cases will future challenges require the same skills that worked in the past. For example, **GE**'s past three CEOs (Reg Jones, Jack Welch and Jeff Immelt) are starkly different people. In leadership succession, GE has done a good job of looking "through the windshield" rather than "in the rear-view mirror" to understand the leadership skills required of the next CEO. Investing in a credible forecast about the future makes it possible to understand the skills and capabilities a CEO will need.

**2. Development**

The best practices in development are different for internal and external candidates. For internal candidates, development begins with the identification of a small number of people who could be made ready in two to four years. Though there is a strong bias for "ready now" candidates, directors must recognize that such individuals exist only in theory.

The odds that the "perfect" person finds his or her way to a leadership opportunity at just the "right" time are so improbable that planning for it is ludicrous. However, a great deal can be done in two to four years to develop an executive, whether it involves rotations in different functional areas, international assignments or something else. A caution regarding internal candidates: When succession planning is cavalier about timing, candidates are either too quick or too slow to develop; those ready too soon become targets for headhunters, while those not yet ready are of little use.

External candidates are usually identified with the help of an executive search firm. Normally, these executives lie beyond the company's reach in terms of development, but in a best-practices approach to succession planning, companies actually bring potential CEO successors in through other positions. This allows the company to make a strategic investment in the new executive's development, as the board not only increases its company's bench strength but also has a chance to explore the executive's likely effectiveness as CEO. Both Jim Donald (Starbucks) and John Chambers (Cisco) ascended to CEO positions this way. The opportunity for the executive and the board to develop their relationship greatly reduces transition risk.

**3. Selection**

As the transition approaches, the internal candidates should be ready. The scanning for external candidates should be updated. The best selection practice involves inviting all internal candidates to give presentations to the board in which they describe their vision for the company's next five years. After a presentation and discussion, the likelihood is--if the development of internal talent has been successful--that a clear winner will be revealed. If none emerges, then it is time for the board to consider external candidates. The risk with external candidates is high--not only do they present an incomplete picture to directors, but the company is an incomplete picture to them.

The uncertainty runs both ways. Whenever risks are high, however, returns are also expected to be high. This means the board must see tremendous upside potential in an external successor, and it also means there is tremendous pressure on the individual selected for the job.

**4. Transition**

A best-practices transition focuses on both the on-boarding process and first 12 months of a new CEO's tenure. Internal and external successors experience on-boarding differently, but a critical presumption is that before the successor's first day, the board has made certain that he or she has begun to develop relationships with board members, had sufficient time with the outgoing CEO to complete appropriate hand-offs and has a sense of the areas that represent burning fires requiring immediate action. On-boarding itself refers to the process of getting up to speed on the job.

Again, internal and external successors will experience this differently, but the two most critical practices here are for the board and the successor to agree on a plan for the first year that includes measurable metrics and milestones and the active engagement of the entire leadership so as to be sure everyone is working from the same playbook. Finally, a coaching plan for the entire first year should be in place. Providing a coach offers a supportive and apolitical resource that, in the end, helps the successor continue to do the personal work he or she began when the company initiated the succession-development process.

**Conclusion**

Hand-offs from one leader to the next are tricky because of the politics and intrigue that surrounds them, the complex nature of the CEO position and the dynamic nature of companies. For that reason, they represent a time when the company is vulnerable. By crafting a thoughtful, strategic approach to succession, the board fully addresses its governance responsibilities and sets the new leader on a firm course toward future success.

*Stephen A. Miles is managing partner in the Leadership Consulting Practice at Heidrick & Struggles.*

*Nathan Bennett is professor of management at Georgia Tech.*

**Do you have an issue you're burning to write about for Forbes.com? Let us hear your suggestions by e-mailing us here.**

OLIVER WYMAN

Delta

# Beyond Best Practices: Revisiting the Board's Role in CEO Succession

Mark Nadler

Of all the ways in which boards have been taking a stronger hand in corporate oversight, few hold as much potential for so much impact over such an extended period of time as the board's active participation in the development of future leaders and the selection of CEOs. So how successfully have boards wielded that powerful tool?

Consider the stark difference between two big-company succession announcements that came on the same day, but involved dramatically different succession scenarios.

The date was November 5, 2007. As the year drew to a tumultuous close, Wall Street had become enmeshed in the subprime lending meltdown, in which billions of dollars in bad loans and shareholder value evaporated within a matter of weeks. One of the companies hardest hit was Citigroup, which eventually was forced to write off more than $18 billion in decimated assets in early 2008. Embattled CEO Charles Prince, under fire throughout much of his four-year tenure from shareholders disappointed with the company's performance, announced his resignation on November 5.

What followed was the highly public spectacle of the nation's largest bank suddenly caught up in a frantic search for a new CEO. As some observers noted at the time, the succession plan at Citibank had basically consisted of asking former Secretary of the Treasury Robert Rubin, a top adviser at the company, to temporarily hold down the CEO job until a permanent replacement could be found. And that's exactly what happened. But in the interim, the company was subjected to an absolute media circus with endless speculation about who had been offered the job, who had turned it down, and who might be next on the list. In the end, the board selected Vikram Pandit, a former Morgan Stanley executive whose small hedge fund had been purchased by Citigroup earlier that same year.

Contrast that with the situation at Time Warner. On the same day that Chuck Prince announced his resignation from Citigroup, Time Warner was announcing that Dick Parsons would be succeeded as CEO by Jeffrey Bewkes effective January 1, 2008. The announcement, which came as absolutely no surprise to anyone, was made by Robert C. Clark, chairman of the Time Warner board's governance and nominating committee. The transition was the culmination of an orderly, structured, two-year process in which the board and management worked together to create a fully articulated view of the job requirements for the next CEO and then monitored Bewkes's readiness to meet those requirements and make the move from president to CEO.

Obviously, when it comes to evaluating boards' roles in CEO succession, the scorecard is mixed. A few boards have made excellent progress on this front, and some have made a decent start. But for many, the game is barely under way, which is a little surprising. Research by our firm (together with the Center for Board Leadership) and others indicates that as recently as 2006 and 2007, at least half of large U.S. companies, both public and private, had no explicit CEO succession plan in place.[1] We continue to watch with dismay as world-famed corporations scramble to find a new CEO to replace the one the board has just forced out. For every Coca-Cola, Target, Microsoft, and McDonald's that selected a new CEO from the inside using an orderly process, you could easily find a Boeing, Ford, or Merrill Lynch that had no well-groomed candidate waiting in the wings. It's still common practice at some companies for the emergency succession plan to exist exclusively in a sealed envelope locked in the CEO's desk drawer, with the designated successor's name remaining a total mystery to the board until a crisis hits. What's more, you don't have to talk with too many directors before it becomes evident that the death notices for the imperial CEO were somewhat exaggerated and the birth announcements for the activist board were a bit premature, particularly when it comes to planning for the transition in the corner office.

Perhaps our expectations were too high. Compared with other governance practices that have significantly changed the way boards and CEOs work together – a focus on board composition and leadership, the appointment of lead directors and the regular use of executive sessions, periodic CEO performance evaluations and board assessments – the widespread emergence of a new approach to CEO succession is still in its early stages.

Let's begin by stipulating that successful CEO succession is a lot tougher than it looks. Why? Because succession planning, unlike many other governance reforms, has less to do with legal requirements and formal procedures and everything to do with the emotional, political, and occasionally irrational behavior of a set of powerful players caught up in the most personal of all professional dramas. No matter how you shuffle this deck, the human wild card keeps showing up when you least expect it. Any succession plan – no matter how detailed, elegant, and deliberate – is destined for trouble if its underlying model is a chessboard instead of a playground. Succession at the CEO level is messy – sometimes beyond description or belief – precisely because it involves so many individual players, each with his or her own set of needs.

This is not to suggest that succession planning is pointless. To the contrary, planning is essential, as long as it takes into account the full complexity of the process rather than focusing unrealistically upon a mechanistic approach that ignores the inherent messiness of such an essentially human process.

To that end, our firm (then known as Mercer Delta Consulting) collaborated in 2006 with the National Association of Corporate Directors (NACD) on a comprehensive study of the role of the board in CEO succession. As part of that project, we identified a list of ten "best practices," based on our interviews with twenty-three directors of *Fortune* 500 companies where the board had an active role in CEO succession planning, where there was a robust succession planning process, and where there had fairly recently been a smooth and orderly hand-off from one CEO to another. The companies involved in the study represented a broad spectrum of industries, including airlines, aerospace, technology, retail, pharmaceuticals, and consumer goods, and included such well-known corporations as McDonald's, Microsoft, and Starbucks.[2]

By and large, the best practices that emerged from those interviews still make sense. But for the great number of U.S. companies where this approach to succession continues to be more aspirational than actual, there is value in revisiting the best practices with an eye toward highlighting some specific ways to make them more realistic and actionable. The key is to bring these best practices to life by taking into account the full range of personal and organizational dynamics that inevitably come into play whenever the top job is at stake.

## Exploring the Three Dimensions of Succession

The selection of senior managers in general, and of CEOs in particular, always involves three critical dimensions: the analytical assessment of a candidate's readiness for the job, the emotional considerations that influence the decision, and the political dynamics that surround the organization's transition from one CEO to another.

These dimensions are always present in one form or another, but they are magnified in unique ways when it comes to identifying CEO candidates, developing them, and then selecting the next leader.

### Analytical

The *analytical perspective* views selection as a rational process, strongly guided by the collection and analysis of objective data through an explicit and defined work process. It is all about gathering dispassionate, hopefully quantifiable, data about each candidate's strengths and weaknesses and then matching those profiles against the explicit requirements of the job. Ideally, the process clarifies the trade-offs raised by each alternative, thus leading to a final selection decision based on objective evaluation of the best available data.

For example, not long ago we assisted a communications company in assessing members of the senior team and rating each as a potential CEO prospect. Each assessment involved a variety of tools – personal interviews; psychometric instruments; 360-degree feedback surveys; and a rating of each executive, by both the chair and the CEO, on seventeen key dimensions that the two of them had selected as the most important attributes for the next CEO. Taken together, that variety of data provided ways to very literally compare and rank each candidate's level of "fit" with the articulated CEO role criteria.

As it turned out, one internal candidate clearly emerged from the initial evaluation as the most serious prospect, by far. Over the next eighteen months the board nominating committee used the same CEO job profile – the seventeen dimensions used in the initial assessment – to evaluate external candidates and to monitor the progress the internal candidate was making. Ultimately, the board decided that the internal candidate's development had progressed to the point where they were comfortable in formally designating him as the CEO's successor.

### Emotional

The analytical assessment of candidates is in sharp contrast to the *emotional perspective*. There is usually some emotional component present in any promotion decision. But it absolutely permeates the CEO succession process from start to finish.

Some CEOs actively avoid working on succession because they would rather not face up to all it implies about aging and mortality. That can be an enormous emotional stumbling block for many

CEOs, and a good many will put it off interminably unless pressed into action by the board. Once the succession process is finally in place, the board must keep a sharp eye out for signs that the CEO is actually sabotaging the process, finding excuses to eliminate promising candidates and thereby starting the process all over again.

Because the choice of a successor is so critical, some CEOs obsess over making the right decision. That plays out in a variety of ways. The CEO might be hypercritical of all potential candidates, subjecting them to endless scrutiny. Or something resembling paralysis sets in; the CEO is simply incapable of settling on any candidate. The decision can also become clouded by unrealistic comparisons: in other words, the experienced CEO compares candidates to himself at this moment, rather than stepping back and remembering what he was like at the moment he was selected as a novice CEO. Consequently, he sets the bar so unrealistically high that any candidate who doesn't have some CEO experience can't possibly hope to pass muster.

When it comes to internal candidate selection, it's impossible to ignore the emotional overtones. Typically, both the incumbent and the candidates have known and worked with each other for years, possibly decades. There might well be strong friendships, or bonds of loyalty, or feelings of obligation, or all of the above. CEOs often find themselves torn, weighing a candidate who has been loyal, steadfast, conscientious, and competent against someone with whom they share little history but has the potential to become a superstar. Beyond that, the stakes are incredibly high for the candidates, and the CEO knows that. When people vie for any other job, there is usually an assumption that if this promotion doesn't work out, other opportunities will come along. Not so with the CEO position; candidates usually get one serious shot at the job, and if they lose out, odds are they won't get another chance to become a CEO unless they give up and go somewhere else. That is a heavy emotional burden for some CEOs to deal with as they think about a pool of candidates they have long-term relationships with.

CEOs, like the rest of us, often experience an unconscious impulse to clone themselves. Even in the face of overwhelming evidence that the company's situation calls for an entirely different kind of leader, CEOs find it hard to resist the natural tendency to gravitate toward people they perceive as similar to themselves. Perhaps more important, CEOs are often drawn to like-minded successors whose appointment will be viewed symbolically as a continuation of their own tenure, much as the first President Bush's election was generally viewed as an extension of the Reagan presidency.

## Political

Finally, there is an intensely *political perspective* to CEO succession. Individuals and groups, both inside and outside the organization, care about the selection of a CEO in ways that far surpass any other appointments. For some stakeholders, support for a particular candidate is grounded in strategic, philosophical, or ideological beliefs about how the company should be run, what businesses and markets it should be in, and what sort of financial performance is expected. For others, it's all about power, and the expectations that a particular choice will have direct implications on who will benefit in terms of position, influence, resources, and career opportunities.

There are four major groupings of stakeholders who figure into the political mix. Clearly, the board has emerged as the most important group of players, a situation that has dramatically changed over the past decade. During the same period, we have also seen a significant increase in the role of outside stakeholders – activist shareholders, potential investors, analysts, the business press, unions, major customers, suppliers, regulators, and various political and social interest groups. For the most part, succession used to be an in-house activity, with occasional lobbying from the outside; today, outside influence has become a huge factor. In an increasing number of situations, the search for a new CEO is being spearheaded by activist shareholders, and their efforts are accelerated and amplified by a business press that is infinitely more excited by the drama surrounding a change in the corner office than by covering the nuts and bolts of routine business news. The third political force includes the candidates themselves. Some adhere to the rule that the best way to win the new job is to steer clear of politics and let performance speak for itself. But others will take matters into their own hands by actively lobbying for their candidacy or trying to sabotage others. Finally, there are various internal constituencies who search for ways to either support their favorite candidate or undercut the competition – office politics at its most destructive and dysfunctional.

## Revisiting the Best Practices

With this framework of the three succession dimensions in mind, let's now take a closer look at the ten "best practices" identified in our 2006 study. It is not our intention to go through the list and discuss how each of the three dimensions of succession applies to each of the best practices. Instead, our goal is to revisit the ten – focusing specifically on several that merit particularly closer attention – and to apply a realistic, integrated perspective to some practices that even the most successful boards espoused more in theory than in practice.

### 1. Plan Three to Five Years Out

**Board and CEO discussions on long-term succession planning should begin three to five years before a CEO transition is expected.**

No question about it: this is the ideal scenario. And it's a best practice followed by such respected companies as Microsoft, McDonald's, Pepsi, and Wyeth. It makes perfect sense; companies are increasingly inclined to promote internally rather than recruit externally, and grooming inside talent takes time. The benefit of a long succession process is the opportunity to fully develop the next CEO through a combination of assignments and activities. More specifically, the directors interviewed for the study described a multiyear process in which the board spends the first two to three years identifying and monitoring the development of serious candidates, then selects an heir apparent who spends the remaining time making the transition through the roles of COO, CEO-designate, CEO, and, ultimately, CEO/chair.

That sounds great. The only problem is that only one-third of those interviewed – and remember, these are the directors whose companies had recently been through successful CEO successions – said their boards actually got involved three years or more in advance of the event. In fact, over half said their boards actually got involved less than two years before the CEO was scheduled to leave (see Figure 1).

The other problem with this best practice is the implication that a single candidate should be identified two to three years in advance. That can be awfully risky, if not impractical. As already noted, a CEO who is fundamentally ambivalent about giving up the job may become a serial "candidate killer," allowing a succession of candidates to advance to a certain point before he sours on them and decides to search for a replacement. Disney's Michael Eisner, for example, became famous for anointing successors and then concluding they were totally unfit to replace him as CEO. In other cases, there is a real risk in putting all your eggs in one basket too far in advance because that single candidate might suddenly find another opportunity outside

**Figure 1. Time Frame for the CEO Succession Process**

Question: How many years before a planned CEO transition (that is, long-term succession planning for a CEO's retirement):
A. Does the board *typically* get involved in the succession planning process (current state)?
B. *Should* the board get involved in the succession planning process (desired state)?

| | Less Than Two Years | Three to Five Years | More Than Five Years | Not Applicable/ Don't Know |
|---|---|---|---|---|
| Current state | 56% | 22% | 11% | 0% |
| Desired state | 6% | 61% | 22% | 0% |

the firm. Talented, ambitious CEO candidates get restless. Their sudden departure in search of more immediate gratification can erase years of planning and leave the succession plan back at square one. One of the most sensational examples of that happened in 1996 when Alex Mandl, the president and CEO of AT&T, got tired of waiting for CEO Robert Allen to retire, and went off to lead a wireless startup, leaving AT&T without an obvious successor. But that was far from an isolated example. Ed Breen, the apparent successor to Chris Galvin at Motorola, left in 2002 to become CEO of Tyco only seven months after being promoted to president/COO of Motorola. History repeated itself in late 2007 when Charles Giancarlo, the heir-apparent to Cisco CEO John Chambers, decided upon turning fifty that he wasn't willing to wait another five years for Chambers to step aside and went off to join Silver Lake, a leading Silicon Valley investment group.

The point is that involving the board in a well-thought-out succession plan three to five years in advance is great, if you can do it – as long as the board fulfills its responsibility by dissuading the CEO from placing all his succession eggs in a single basket. A few years ago, the CEO of a *Fortune* 500 health care company hired a new COO with the explicit intention of grooming him as a successor. In almost every way, their five years together literally became a textbook case of how succession should be done; the transition was written up in business magazines and professional management journals as an example of succession planning and execution at its best. And it was, with just one caveat; if the heir apparent, at some point in the five years, had been hired away by another company, or become physically incapacitated, or involved in a scandal, or just decided to go live in the mountains and write poetry, all bets would have been off. There was no other internal candidate; there was no Plan B.

The moral of the story? By all means, start early, get the board involved, provide plenty of lead time – but be sure to spend time developing the entire pool of executive talent, rather than prematurely placing all your bets on a single candidate.

## 2. Ensure Full Board Involvement

**The full board should be involved in CEO succession planning; the process should not be relegated to a committee.**

Directors in the NACD study stressed the importance of involving all board members at critical stages in the succession process: setting the criteria for the CEO role, evaluating candidates, and making the final decision. That marks a dramatic departure from the traditional practice in which the CEO owned the process and the board's involvement was often limited to a few members of a board committee.

Indeed, our firm's research and experience clearly indicate the gradual emergence of a new model of CEO succession.[3] Until the 1990s, the prevalent approach was basically a "concurrence model," which can still be found today. In this model, the process begins when the CEO decides that it is time to start thinking about succession. He identifies potential candidates, provides them with some development opportunities, tests them, and possibly offers further development. Periodically – at times of his choosing – he informs the board, or, more often, a few of its members, how the candidates are coming along. As he nears the end of his term – usually, sometime in the final two years – the CEO chooses a successor and takes his selection to the board for an up or down vote. And they usually concur – hence, the "concurrence model."

More recently, we have seen two new and very different models showing up in boardrooms – the "collaborative" and the "crisis" models. The "collaborative model," which seems to be emerging as the dominant approach, still positions the CEO as the major player in the succession process, in terms of identifying and developing candidates, but includes the board as a full participant in terms of overseeing the process and making the final selection. The entire board is involved, but the lead director or a committee chair is usually designated to work as the CEO's primary partner throughout the process.

Of course, the "collaborative model" assumes there is someone for the board to collaborate with – presumably, an incumbent CEO who is performing reasonably well and has substantial credibility with the board. Yet, more and more, that isn't the case; in 2006, nearly one-third of CEO departures at large companies were involuntary, compared with one in eight in 1995, according to Booz Allen Hamilton's 2007 study of CEO turnover.[4] With increasing frequency, boards are employing a "crisis model" of CEO succession, in which the lead director or the chair of one of the key committees drives an accelerated succession process, often involving an outside search, within a tightly compressed time frame.

The numbers from our 2006 study with NACD demonstrate that the collaborative model was quickly growing in popularity during the middle years of the decade. Only 11 percent of the directors in the survey said their boards were still using the "concurrence model," whereas 39 percent said their boards had adopted a collaborative model. And the momentum is clearly building; half the directors, in fact, said they would prefer to go beyond the collaborative model and give the board primary responsibility for running the succession process, with the CEO in a secondary role – providing input only as requested. Again, that is more aspirational than actual; only 28 percent said that was how their board actually operated (see Figure 2).

The role of the board vis-à-vis the CEO is only one aspect of this issue. The other is the importance of involving the entire board, rather than a small number of board leaders or members of a particular committee. As mentioned earlier, there are some board members who are happy to abdicate any active role in succession until it's time for a final vote. In our view, the time for that kind of passive role is over. Every director should be required to take part in the process, have a say when CEO selection criteria are developed, and be expected to personally interact with candidates so that when the time comes for a vote, they can make an informed decision rather than following the lead of the CEO or a committee chair. At the other end of the spectrum, there tend to be a few board members who would love to dominate the

**Figure 2. CEO and Board Collaboration**

Question: How do CEOs collaborate with boards on CEO succession planning?
Current state: How they typically work together
Desired state: How they should work together

| CEO Responsibility ◀ | No Board Engagement | Low Board Engagement | Moderate Board Engagement | High Board Engagement | Exclusive Board Engagement | Board Responsibility ▶ |
|---|---|---|---|---|---|---|
| | CEO has primary responsibility and keeps the board informed | CEO has primary responsibility and asks the board for input | CEO and board are jointly responsible and work together | Board has primary responsibility and asks the CEO for input | Board has primary responsibility and keeps the CEO informed | |
| Current state | 11% | 17% | 39% | 28% | 0% | |
| Desired state | 0% | 6% | 39% | 50% | 6% | |

process, if given the opportunity, which can leave candidates with a skewed sense of the board, its members, and their opinions. Active involvement by all directors should be the standard in every boardroom.

As a best practice, it makes sense for a key committee – most often, the governance and nominating committee – to oversee and work closely with management on the process for identifying, developing, and vetting potential candidates, and to periodically report to the full board on where things stand in terms of the development and readiness of potential candidates. The role of the full board is to provide input to the committee, to avail itself of appropriate opportunities, to become familiar with potential candidates, and, of course, to make the final selection decision.

## 3. Establish an Open and Ongoing Dialogue and an Annual Review

**The board and the CEO should maintain an open and ongoing dialogue on succession planning and should devote substantial time to discussing the topic.**

If the ultimate goal is to make succession a process rather than an event, then this is an essential best practice. One of the more positive signs we're seeing is that periodic reviews of the succession plan and the progress of potential candidates have become fairly routine items on board agendas, showing up at least once a year and frequently more often.

Companies have devised various ways to accomplish the same goal. Some boards devote half a day, once or twice a year, to a thorough review of how candidates are progressing toward the goals of their respective development plans. Others spend a full day reviewing the succession plans not only for the CEO but for all his direct reports as well. Some boards also view these reviews as a logical opportunity to revisit the effectiveness of the company's overall leadership development processes.

These discussions provide the greatest value when positioned within the larger context of talent development. Not long ago, we were given a dual assignment by the compensation committee of a mid-sized media company: first, to determine whether any of the CEO's direct reports should be considered serious candidates for the top job, either near-term or at some point farther down the road; and second, to assess each executive's overall strengths and weaknesses and to help them put together a personal development plan to discuss with the CEO.

It turned out to be a valuable exercise for everyone involved. It revealed, among other things, that although the number two executive was certainly capable of keeping the company up and running during a crisis, no one (except for him) thought he was a viable candidate to become CEO on a permanent basis. At the same time, it became clear that three younger members of the senior team had tremendous potential, which would require providing each with different development opportunities over the next five years or so. The implication was clear: someone new had to be brought in very soon, at a very senior level, to be groomed as a bona fide near-term successor. As a result, a very capable, highly experienced executive was recruited from the outside to join the senior team, and development plans were put in place for the three younger executives with an eye toward long-term succession.

What was particularly interesting about the process was the conversation it prompted among board members. After hearing us explain why one executive was on our list of long-term CEO candidates, a board member mused, "She's been with the company for eleven years. If she's so good, why is this the first time I've ever heard her name?" The answer, clearly, was that up to that point the board and the CEO's predecessors had never engaged in any regular discussions of succession plans or of any but the most obvious CEO candidates.

The cadence of these discussions has a lot to do with how far in the future the transition is likely to be. As the CEO's planned departure draws closer, it is only natural for the conversations to become more frequent and more detailed. However, there is an element of risk involved here. Taken to extremes, you can find yourself with a nonstop assessment process in which it becomes all too easy for the board to get hung up on isolated and relatively unimportant episodes. A few years ago, we worked with a private-equity-owned firm in which the president was being trained as quickly as possible to become CEO. As with most PE-portfolio companies, the board met monthly, and at each meeting, the president took on an increasingly prominent role. After meetings, the directors would compare notes on the president's performance. Because the conversations were held so frequently, the board sometimes became fixated on a particular slip-up or an uncharacteristically weak performance and had to be reminded to take the long view and focus on the president's overall progress and performance.

The issue is one of balance. There is enormous value in regularly scheduled, substantive conversations between the board and the CEO to review the progress of CEO candidates and of the overall talent development program. The board's challenge: knowing how deeply to dig into details without getting so hands-on that they start to act like super-HR directors.

## 4. Develop and Agree on Selection Criteria

**Criteria for the new CEO should be developed with the company's future strategic needs in mind.**

Let me be candid: my personal belief is that this "best practice" from the 2006 report is unquestionably valid, yet somewhat limited.

I fully endorse the notion that the board and the CEO should develop and agree on selection criteria for the new CEO, for three reasons. First, I have participated in far too many boardroom debates over the relative merits of various CEO candidates in which it is clear that at a surprisingly late stage in the selection process there is an incredible lack of consensus among board members about the most important professional attributes and personal qualities they are looking for in the next CEO. When that happens, it is hardly surprising that the board ties itself in knots trying to settle on a single candidate; how do you decide who is "best" when you can't agree on a definition of "best"? It seems painfully obvious, but the fact is that boards frequently get much too far down the succession road without taking the time to agree on what they're looking for.

The second issue is that assessment is essential for both development and selection, and there is no rational way to do assessment in the absence of explicit criteria. Establishing those criteria is the critical first step in measuring the distance between where candidates are today versus where they need to be, and then having a reasonably objective way to assess individual and comparative progress against the goals.

Third, explicit criteria are central to succession "story lines." One of the most useful tools in any succession situation is a well-developed, concise explanation of why the transition is happening, why it is happening now, and why the new CEO was the best possible choice – in other words, a "story line." And the easiest way to answer the question, "Why is this the best candidate?" is to be able to match the individual with the requirements, framed as a clear, concise set of criteria that squarely address the organization's biggest priorities and the one or two attributes that were the key differentiators among the top candidates; for example, "Our next CEO has to be someone with the deep knowledge of our company and our industry to lead a period of intense organic growth," or "To meet our growth projects, we need a CEO with global experience in world-class manufacturing operations."

In my experience, once you agree on the criteria, it's a simple matter to extrapolate from that all the essential communications, ranging from public announcements to very private conversations with the unsuccessful job candidates. The result is a message that is candid and consistent – one that will carry you through the entire succession event.

However, there is one caveat. The statement that the criteria "should be developed with the company's future strategic needs in mind" is absolutely true – but it would be a mistake to stop there. Here's why.

A few years ago, we were asked to help with the transition from one CEO to another at a major financial services company. The company's strategy was clear: the time was fast approaching when the company would need to become a publicly traded corporation. As a result, the retiring CEO/chairman made the personally difficult decision to look beyond his trusted circle of top executives, some of whom he had worked with for more than a quarter of a century, to find a CEO with senior-level experience at a public company within the same industry. He ultimately recruited a top executive away from a major competitor – a gentleman with precisely the credentials he was looking for, and a resume much more compatible with the skills and experience the new CEO would need.

Yet almost as soon as the appointment was announced, the outgoing CEO began feeling uncomfortable about his decision. He was disturbed by what struck him as his successor's arrogance, aloofness, and barely hidden disdain for the top managers he had inherited. And before long, the new CEO was embroiled in a highly publicized scandal involving his relationship with an employee and his use of corporate funds. In hindsight, there is little doubt the new CEO was technically qualified to address the company's immediate strategic challenges. What hadn't been examined as closely was whether he had the character to lead the company and build value over the long haul.

The point is that when it comes to developing succession criteria, focusing on the company's strategic challenges is a good place to start – but a terrible place to finish. Consider Gap; Mickey Drexler, with a great sense of fashion, made the clothing chain so successful that it eventually grew out of control. The owners ousted Drexler and replaced him with Paul Pressler, a Disney executive known for his financial prowess, and sure enough, he quickly brought financial discipline to the company, to the great delight of shareholders. But Pressler was a finance guy, not a fashion guy; he knew how to bring growth under control through financial discipline, but not how to generate growth through creative merchandising.

That's the phenomenon we refer to as the CEO's Act II.[5] A CEO is recruited to solve a particular problem – think of that as Act I. Assuming he or she is successful, the organization then moves on to a new set of challenges, often requiring entirely different management skills or leadership styles – we'll call that Act II. As it turns out, the very attributes that made the CEO the best possible candidate to attack the challenges in Act I will often be ill-suited to the problems in Act II and, in some cases, might even exacerbate them.

The implication for succession is that there is a huge risk in basing CEO selection criteria too narrowly on the specific attributes required to meet an immediate challenge. I am reminded of a recent board meeting of a small manufacturing company in desperate need of an immediate turnaround. The incumbent CEO had quit before the board had a chance to fire him, and now the board was reviewing a serious candidate to replace him. Initially, board members focused on his industry knowledge and turnaround experience. Gradually, questions turned to his operating experience, his ability to deal with customers, and his marketing savvy. After two hours, the board concluded that assuming he met the basic requirements in all the other areas, the three attributes they most cared about were his ability to recruit and effectively lead a great senior team, his decisiveness, and his personal integrity. My hunch is that they landed on a set of attributes that enabled them to hire a CEO who not only will do well in Act I, but will also be well suited to succeed in Act II.

Again, starting the selection criteria with the company's strategic requirements makes absolute sense. But as a best practice, the criteria should address the full range of requirements in the areas of strategy, operations, interpersonal relationships, and personal qualities.

## 5. Use Formal Assessment Processes

**Formal assessment processes provide information that helps boards objectively assess candidates and identify development needs.**

The standard performance appraisal tools most companies routinely employ rarely generate the kind of sophisticated data you'd like to have in front of you when it comes to planning who will lead your company into the future. That should come as no surprise. Despite enormous effort and great intentions, performance appraisals tend to become more perfunctory and less helpful the higher you go in the organization. Too often, they focus disproportionately on past performance rather than future development. They rarely indicate how the individual might do in a job with different requirements.

As a best practice, directors believe that potential CEO candidates should be subjected to periodic, formal assessments based on data gathered from a variety of sources who are asked to rate candidates against specific criteria. In particular, directors pay close attention to 360-degree feedback appraisals in which supervisors, peers, and direct reports rate each individual on such dimensions as management ability, leadership skill, strategic thinking, and operational knowledge.

Although there are any number of ways to design the assessments, I would argue strenuously in favor of customized sets of assessment tools carefully designed to meet the particular needs of each situation. Consider the following two very different examples.

At the media company referred to earlier, where we were asked to assess the viability of every senior team member as a potential CEO candidate, the assessment package we put together included

- A rating (arrived at together by the CEO and the executive chair) of each candidate on fifteen different selection criteria, including breadth of management experience, relevant business knowledge, customer focus, and emotional strength and maturity.
- An in-depth interview lasting two hours or more, conducted by one of our consultants and touching upon a host of personal and professional issues.
- An analysis of the widely respected Hogan Leadership Forecast, a psychometric instrument each candidate completed.
- Reports by each candidate describing their academic and professional backgrounds and explaining what they saw as the company's greatest strategic challenges and their ideas on how these should be addressed.

The result was a rich set of data on each candidate and a straightforward way to compare how closely each measured up to the selection criteria. But there's something missing: a 360-degree assessment. After much discussion, it was agreed to forego the 360 in this initial round of assessments because nearly the entire senior team had either been with the company, or in their current jobs, for such a short period of time that ratings by their peers and subordinates would have been next to meaningless. However, at the end of the project we strongly urged that 360s be introduced into the regular assessment process in the not-too-distant future.

In contrast, consider the assessment package we developed with a global financial services firm, an infinitely more stable organization in which senior executives had extensive experience with the company. The clear emphasis was on the 360-degree feedback, which was structured around a set of four key dimensions: strategic thinking, business results, people leadership, and personal effectiveness. The assessment included online feedback surveys involving numerical ratings from supervisors, peers, and employees, as well as confidential interviews (conducted by our consultants) with each executive's direct reports and a conversation with the CEO in which he provided numerical ratings, with color commentary, for each executive. The process concluded with a personal meeting between each executive and the CEO to go over the data and agree on developmental goals. The 360 was then repeated regularly, providing explicit data about each executive's progress – or lack thereof – in each critical area.

The two assessment approaches just described were dramatically different, and intentionally so; when it comes to assessment tools, CEO selection is not the place for a one-size-fits-all approach.

These examples also illustrate some related best practices suggested by the directors in our NACD survey:

- **Conduct formal assessments early on, and use them regularly.** Repeating the assessments at critical junctures in the succession process can benchmark executives' progress and highlight emerging issues that deserve special attention.
- **Use an independent third party.** As self-serving as this sounds, directors said they found it helpful to have appraisals conducted by outsiders, who are viewed as more impartial and less threatening than internal people.
- **Assess all of the CEO's direct reports.** The reality is that in any given situation, only a small number of top executives are viable CEO candidates. Nevertheless, periodic assessments of the entire senior team provide the board with valuable information about all the top executives, which can help them consider the entire pool of possible candidates before settling prematurely on just one or two of the most obvious contestants.

## 6. Develop Internal Candidates Rather Than Hiring Externally

**Boards typically prefer developing internal candidates to recruiting externally for a new CEO.**

Most directors in the NACD study said they strongly preferred developing home-grown talent rather than recruiting a CEO from the outside, and with good reason. Various studies suggest that hiring CEOs from the outside can result in everything from a mass exodus of top talent to an immediate drop in stock price to a long-term decline in company performance. Boards have concluded that it's just too hard to know what you're actually buying when you recruit a supposed superstar from the outside. For that reason, the hiring of outside CEOs at U.S. companies appears to have peaked in the mid-to-late 1990s; today, about two-thirds of CEOs are promoted from within.

The good news is that boards have learned from experience. The era of charismatic, celebrity CEOs led to a phenomenon in recent decades that Rakesh Khurana artfully captured in the title of his excellent book, *Searching for a Corporate Savior.*[6] These days, most boards seem to have tempered their expectations and adopted a more realistic approach.

I experienced that firsthand a few years ago at a digital media company where the CEO had departed unexpectedly. The board, though less than excited about the COO – let's call him John – decided that to maintain stability, it would have him act as CEO on an interim basis while they had a leading search firm line up some top-notch outside candidates. But a funny thing happened: John's performance was far better than any of the directors had expected. He didn't become any more charming or charismatic, but he quickly brought stability, focus, and, ultimately, forward momentum to a chaotic company at which key players had been streaming out the door. After six weeks, the director overseeing the search confided to me, "You know, I wouldn't go so far as to say I've fallen in love with John, but unless the headhunters come up with somebody who's so clearly head and shoulders above him that they knock my socks off, John's got the job."

That's the way the equation seems to be working out these days; the burden of proof is on the outside candidates to demonstrate that their potential performance far exceeds the internal candidates' established track record. In the battle of dueling succession clichés, "familiarity breeds contempt" gets trumped by "better the devil you know than the one you don't."

In this paper we have already addressed some of the best practices specifically related to the development of internal candidates. In our NACD study, the directors described several specific approaches (see Figure 3). The most common is to provide top executives with a succession of progressively more responsible and challenging jobs, with the goal of guaranteeing that they experience a rigorous array of challenges that will test and tone them as they prepare for the top position.

## 7. Interact with Internal Candidates

**Board members should be given ongoing opportunities to interact with internal candidates in various settings.**

Notebooks filled with assessment data have their place, but at the end of the day, there is no substitute for personal observation. Most of us prefer to form our own judgments as to how a candidate answers questions, handles stress, and interacts with others. No headhunter "candidate summary" can fully describe someone's personal presence, communication skills, absence or abundance of charm and humor, or ability to think on his or her feet.

**Figure 3. Development of Internal Candidates**

Question: How do boards develop internal candidates for the CEO position?

| | Board Member Has Experience With (%) | Board Member Rank Order of Effectiveness |
|---|---|---|
| Giving a candidate company assignments designed to broaden his or her experience | 83 | 1 |
| Having him or her work closely with the current CEO | 83 | 2 |
| Involving a candidate in multisource feedback or executive assessment process | 83 | 3 |
| Having board members interview a candidate and give him or her feedback | 56 | 4 |
| Having a candidate serve on another company's board | 50 | 5 |
| Providing him or her with coaching from a professional executive coach | 61 | 6 |
| Providing external education (such as executive M.B.A., leadership centers, and so on) | 61 | 7 |
| Other | 6 | NA |

For outside candidates, that places disproportionate importance on the job interview, easily one of the most artificial and unrepresentative forms of human interaction ever devised. In theory, hiring from the inside should afford directors virtually infinite opportunities to size up each candidate over a significant period of time and in a wide variety of relatively meaningful situations. The question is whether that's what actually happens.

Once again, reality falls far short of the ideal. At many companies, the most common form of interaction between directors and potential CEO candidates continues to be the time-honored "dog and pony show," in which managers are ushered into the boardroom to deliver tightly scripted, well-rehearsed formal presentations on specific topics. Fortunately, many boards seem to be losing patience with this practice; they're spending less time on presentations, and more time on questions and discussion. That provides the board with better information about the topic at hand and better insights into what each manager has to offer beyond presentation skills.

Nevertheless, these infrequent appearances in the boardroom can have less than ideal outcomes. Not long ago, we helped the board of a publishing company identify a set of potential internal CEO candidates. We met with the board governance committee to discuss our findings, and one of the candidates – in fact, the one we rated number one – drew surprised reactions from board members. "Are you kidding?" one director asked. "You're seriously recommending that arrogant little s—t?"

We were somewhat taken aback. Certainly, the candidate – the head of one of the company's two most important divisions – came across as fairly self-assured, but we had also found him to be personable, funny, even charming. We took a closer look, and found that over the course of two years, the candidate had met with the board four times to provide updates on his division's performance. For this very ambitious young man, these board appearances induced massive anxiety and he overcompensated; rather than conveying confidence, he exuded arrogance. Nobody bothered to tell him how the board was reacting, so he kept doing the same thing each time he met with them. As a result, the board's view of him was dramatically different from the way he was seen in normal situations by his colleagues and employees.

From that standpoint, there is some cause for concern that directors in the NACD study put board presentations at the top of the list of practices that they find most helpful in developing insights about CEO candidates. The good news, as illustrated by the results shown in Figure 4, is that most directors in the study also found it helpful to engage with candidates outside the boardroom. Spending time with executives at company offsites seems to be a favorite, and it is easy to see why. Offsites generally provide a mix of both formal and informal sessions in a more relaxed atmosphere than the office or the boardroom. They also allow directors to see how potential candidates interact not only with the board, but with their peers, as well.

The directors described other settings that can help round out the picture of candidates' personal and professional capabilities. Many boards invite key managers to join them at social events that coincide with board meetings, providing opportunities for relatively relaxed conversation. Some board members accompany top management on trips abroad or site visits. One director said that at his company, board members attend three meetings each year of divisional management committees, which allows them to see how candidates interact with their own people, and in the CEO's absence.

**Figure 4. Approaches to Meeting Internal Talent**

Question: How do board members meet and develop personal insights about the company's internal candidates?

| | Board Member Has Experience With (%) | Board Member Rank Order of Helpfulness |
|---|---|---|
| Executives make presentations at board meetings | 67 | 1 |
| Executives attend board offsite meetings or retreats | 67 | 2 |
| Executives meet individually with a board member or groups of board members | 56 | 3 |
| Executives attend board dinners or other social events | 67 | 4 |
| Other (please specify) | 22 | NA |

That last point raises a sticky issue: How deep into the organization should directors go in their search for complete information about CEO candidates? There is a delicate balancing act involved here, one that is increasingly common as directors feel more and more responsible for obtaining independent information – on a wide range of topics – unfiltered by top management. It makes perfect sense for directors to be curious about how potential CEOs behave in their natural environment, not just in the boardroom or at offsites under the CEO's watchful gaze. Realistically, however, there is endless potential for mischief, politicking, mixed messages, and unintended confusion whenever directors wander unattended into the dark reaches of the organization. That's not to say they should never go there – but clear ground rules can establish who goes where and says what.

## 8. Stage the Succession but Avoid Horse Races

**The succession should be structured and supervised, but obvious horse races should be avoided.**

Despite the now legendary three-way contest to select a successor to Jack Welch at GE, directors were emphatic in their belief that highly publicized horse races are rarely conducive to successful transitions. They might provide great entertainment to business journalists and office politics junkies, but their potential damage to the organization is immense.

Of course, even in the absence of any public announcement that the race is on, it is practically impossible to disguise the fact that a number of people are being prepped for Big Things in the future. That's only natural; you can't hide the fact that certain people keep taking on increasingly important roles, and after a while it becomes fairly obvious which emerging stars constitute the next generation of leaders. Given the inherently political nature of most organizations, it is not at all surprising that people try to handicap the competition and figure out where to place their personal bets. There is no practical way to stop any of that from happening, and little point in trying.

At the same time, there is almost nothing to be gained by publicly hoisting a starting pistol, announcing the candidates, and then orchestrating a head-to-head, winner-takes-all competition for the top job. As soon as that happens, people start to take sides, forming coalitions and alliances. Political considerations start to permeate business deliberations. Competition between individuals and factions can divert attention and sap morale. If things get out of control, outsiders get involved; as journalists and analysts speculate on who is ahead and what the implications might be, investors, suppliers, and customers can all get nervous. And once a choice is made, the one-time stars who have now been labeled “losers” usually feel they have no future at the company – as was the case after widely followed horse races at GE and Pfizer – and as a consequence, the company inevitably loses some of its top talent.

The reality of a horse race may be impossible to avoid, particularly in long-term succession processes that last three to five years. Most directors recommend that designating a clear front-runner – perhaps two years in advance – is the best way to defuse the competition, and that makes sense – just as long as you don’t short-circuit the process prematurely, as suggested earlier, and find yourself with no backup plan should the front-runner suddenly drop out of the race.

## 9. Have the Outgoing CEO Leave or Stay On as Chair for a Limited Time

**The outgoing CEO should either leave the board immediately or stay on as chair for a transitional period of six to eighteen months, maximum.**

At many companies, the appointment of a new CEO often means that the retiring CEO will stay on for a while in some suitably altered role, often as board chair. But more than half the directors in the best practices survey recommended that the departing CEO should make a clean break – giving up both the CEO and chair roles – as soon as the new CEO takes over. What’s more, the directors recommended that if there must be some period of transition during which the previous CEO remains as chair, then it should be for a very limited time, preferably six months and certainly no more than eighteen.

Needless to say, this is one of those decisions that is directly related to the specific circumstances of any given transition. For starters, what is the business situation surrounding the CEO’s departure? Is the company doing poorly or well? Are major stakeholders demanding or expecting a major change, or are they looking for continuity? Is the new CEO an outside hire or a home-grown successor? Is the retiring CEO the founder, a major shareholder, or a member of the family that controls the company? And most important, does the board view the new CEO as a fully seasoned top executive, ready to take over from Day One, or did the board merely settle on the best available candidate without finding anyone they thought was fully prepared for the job?

The fact is that in various situations, and for a variety of reasons, some boards are extremely nervous about installing a CEO without retaining what is sometimes described, only partly in jest, as “adult supervision.” The assumption is that the old CEO can provide oversight or an institutional memory to help avoid repeating past mistakes, and act as a sounding board or perhaps even a mentor and coach. That desire for an orderly and gradual transition is easy to understand – but it also involves some serious risks:

- It is extremely difficult for the new CEO to develop her own agenda and set a new course for the company without appearing to repudiate a predecessor who is sitting at the head of table.
- A new CEO will find it hard to exert leadership in the boardroom if directors continue to look to the old CEO – in the most literal sense – for clues about how they should react.
- The most extreme risk is one we have seen play out time and time again in recent years at companies such as Dell, Nike, and Starbucks: the continued presence of the former CEO – particularly, though not exclusively, when the former CEO also happens to be the company founder – seriously increases the board's readiness to replace the new boss with the old boss. When a CEO hits a rough patch, it's all too easy for the board to hit the eject button if the former CEO is sitting right there and lobbying to get his old job back so he can return the company to its glory days. Even when things don't go that far, the new CEO becomes acutely aware that what the board and former CEO hath given, they can easily take away.

If, in spite of all that, the board decides that there should be some transition period in which the incoming and outgoing CEOs overlap (with the departing CEO as chair), there are some ways to manage and, it is hoped, limit the risks:

- The roles of the CEO and board chair should be defined with total clarity, removing any question about who is responsible for what.
- Everyone should pay attention to managing the symbols of power. For example, the old CEO simply has to give up his old office; better yet, he should move to a different floor, or a different building.
- The lead director should be prepared to act as mediator, as needed.
- Directors should be sensitive to their own behavior and the dynamics of the boardroom. Even simple things such as automatically looking to the chair for his or her response when the new CEO says something controversial can take on enormous significance.

There is no overstating what an emotional minefield the transition period can be for both the new and departing CEOs, creating awkwardness or even friction between two leaders who might have previously enjoyed a terrific relationship. The principals generally brace themselves for a gradual change in their relationship; it always seems to come as a surprise that everything changes the very moment the transition is announced. "It's like someone switching on a light," one CEO told me. "It happens that fast." Suddenly, the balance of power in their long-term relationship gets stood on its head. In an instant, the retiring CEO becomes history and the new CEO becomes the center of attention.

The interplay of emotions is deep, intense, and somewhat unpredictable. In our experience, most of the key players involved – both the new and old CEOs – have told us that if they had it all to do over again, they would have shortened, if not totally eliminated, the transition period from one CEO to the next.

## 10. Prepare a Comprehensive Emergency Succession Plan

**Emergency succession planning should be dealt with as soon as a new CEO takes the helm. The board should review the plan every year thereafter.**

The lowest common denominator of succession planning is the question I heard a chairman put to his CEO: "Who takes over if you get hit by a truck?"

It doesn't get much more basic than that. And yet, the directors interviewed for the best practices study estimated that one in ten companies have no emergency succession plan at all, and that at another 17 percent, the CEO prepares a letter with instructions to be opened only if there's a crisis, and nobody sees it, discusses the plan, or suggests that perhaps there might be other alternatives (see Figure 5).

In this day and age, given the variety of risks companies face and the speed with which news of the crisis can start eroding value and undermining the organization, it defies all logic for any company to go without an emergency succession plan. The stakes are simply too high.

In fact, the "what if the CEO gets hit by a truck" approach to emergency planning doesn't go nearly far enough. As one director suggested, boards ought to be thinking in terms of "an Eliot Spitzer scenario" in which some regulatory action, natural disaster, or wholly unanticipated chain of events somehow necessitates the immediate and wholesale replacement of not just the CEO, but the entire management team. A crisis of that scale is realistic in today's world, and it is inherently irresponsible for any board to ignore such a possibility and fail to plan for it.

Perhaps the ultimate "best practice," in terms of a board effectively handling a multiple-succession crisis, was the situation McDonald's experienced in 2004. When CEO Jim Cantalupo suffered a fatal heart attack, the board acted within hours to promote COO Charlie Bell to the top position and named one of its outside directors as non-executive chair. Then, just seven months later, Bell was diagnosed with terminal cancer, and the board acted quickly again to promote Jim Skinner, another well-prepared executive. The board handled two wholly unanticipated succession events within seven months of each other, reaping the benefits of solid emergency planning and an outstanding talent development process. As a result, the immensely successful turnaround that McDonald's launched in 2002 continued without interruption, despite the abrupt and tragic changes in the corporate suite.

The McDonald's situation was a wake-up call for many boards. Today, most leading companies have emergency succession plans, although it isn't clear whether all of them are dusted off and reviewed on a regular basis. For companies that have no plan, there is simply no excuse. As soon as a new CEO enters office, it is the duty of the board to instruct him or her immediately to develop an emergency succession plan, to discuss it with them, and then to review and update the plan with them on a regular basis.

**Figure 5. Emergency Succession Plans**

Question: On the basis of your experience as a board member, how do you believe that *most* boards treat emergency succession planning (used in the event of an unforeseen loss of corporate leadership)?

| | |
|---|---|
| 56% | There is an emergency succession plan in place that is reviewed at least annually. |
| 17% | There is an emergency succession plan in place, but it is rarely reviewed. |
| 17% | The CEO prepares a letter of instruction for emergency succession, to be opened if needed, but it is not discussed ahead of time. |
| 11% | There is no emergency succession plan. |

# Summary

We began this paper by stipulating that the CEO succession process is hard work – much harder than it is often portrayed by governance experts or business journalists, who are quick to excoriate any board that suddenly finds itself with an empty CEO office and no obvious candidate in sight. Granted, in a perfect world, that would never happen, and every board should strive to make sure that it doesn't. But any endeavor that, at the end of the day, is all about a group of people trying to find the perfect person for an incredibly difficult job is bound to fall short of perfection.

There are any number of very specific and quite practical best practices that boards can employ in order to do a better job of developing top talent and selecting new leaders. The ten best practices discussed in this paper combine the seasoned insights and experience in the trenches of directors at companies that have actually done succession well.

We have attempted to take those best practices one step further, adding additional texture to the succession picture by overlaying what we've experienced as the three ever-present dimensions of the process – analytics, emotions, and politics. The best succession processes acknowledge and integrate all three elements.

Clearly, the old approach to succession wasn't providing companies with the caliber of talent they needed to meet a host of new demands. In the past, the CEO would simply persuade the board that he had found a successor who had "the right stuff" – without a specific understanding of what constituted "the right stuff" or how it might actually equip someone to deal with the challenges awaiting the next CEO. More and more boards are moving way beyond that anachronistic model. At the same time, it would be equally foolhardy to think that succession can be reduced to an elaborate, objective process that somehow eliminates the human factor. Again, that's totally unreasonable. Instead, the true best practices combine the benefits of individual insight and observation with the analytical rigor of deliberate processes, with the goal of identifying and developing the optimal talent at the top.

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## About Oliver Wyman Delta

Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational change and transformation, and leadership development.

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- Build an engaged and high-performing Board of Directors
- Manage executive talent and CEO succession
- Redesign organizational structures and processes
- Manage the dynamics of change
- Develop and implement new strategies
- Shape a culture consistent with your strategy
- Use communications to engage and mobilize
- Apply metrics to measure performance and impact



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**HIGHLIGHT:**

For too long, boards have relied on rules of thumb and conventional wisdom when picking CEOs. So we took a look at the numbers, and found some surprises.

**BODY:**

It's been eight years since the passage of Sarbanes-Oxley, and despite all the work and worry it created for corporate directors, the new regulation did bring about one unambiguously positive change: It led boards to finally wrest control of CEO succession away from incumbent chief executives, who often held too much power over the process.

Today, corporate boards are more proactive about (and simply better at handling) leadership succession, but they still face a significant challenge in picking the right candidates. That's partly because succession decisions have been guided by too little data and too much reliance on rules of thumb, anecdotes, and even fads. During the mid to late 1990s, for instance, after Louis Gerstner's brilliant turnaround at IBM, boards tended to focus on big-name outsiders as the CEO candidates of choice. In the past decade, the sentiment has shifted, and a procession of thinkers, some of them writing in HBR, have argued forcefully that internal candidates are the better bet.

To give boards guidance based on real evidence, Spencer Stuart conducted an 18-month study of the 300 CEO transitions at S&P 500 companies that took place from 2004 to 2008. (For more on our methodology, see "How We Crunched the Numbers.")

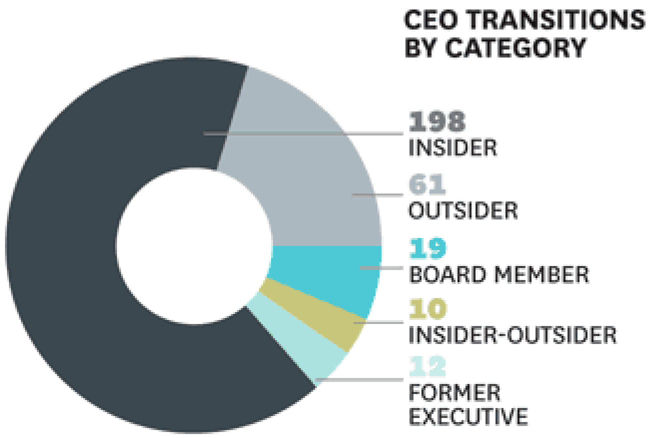
How We Crunched the Numbers

We examined CEO transitions at S&P 500 companies from 2004 to 2008. Over this time, 300 new CEOs were appointed. The CEOs fell into five categories: insiders, outsiders, board members, former executives brought back to retake the helm, and insider-outsiders (executives brought in as the number 2 and then promoted within 18 months).

We began our assessment by looking at more than 25 variables, including company condition, industry sector, whether the new leader was a first-time CEO, his or her functional background, whether he or she had prior public-company board experience, and how many direct reports were replaced in the first year of tenure.

We then evaluated the company's performance under the CEO on the basis of three quantitative measures: shareholder returns relative to peer companies and the overall market, revenue growth, and profit growth. To gain a qualitative sense of company performance under the new CEO, we conducted interviews and examined public information. Specifically, we analyzed changes in the company's reputation, evidence of innovation, and the board's evaluation of the CEO's performance.

We then ranked the CEOs into four quartiles: the top quartile of CEOs were "outstanding," the middle two were "solid," and the bottom-quartile CEOs were "poor."




The results contained several surprises. Contrary to conventional wisdom, our analysis showed that insiders and outsiders have performed about the same, plenty of each fell into the highest and lowest performance categories. Whether a company chose a CEO from inside or outside did matter, but whether the choice turned out to be wise depended mostly on the health and competitive position of the company at the time of succession.

Another surprising finding: Board members who stepped in as CEO outperformed all other types of candidates. Often a board member is a last resort, someone who is turned to in desperation when a company can't find other suitable candidates. But in fact, directors-turned-CEOs represent a strong blend of insider and outsider. They have more company knowledge than a pure outsider, but they don't have the constraints of a pure insider when it comes to making unpopular decisions or leading painful changes. Having been on the board, they have deep knowledge of a company's strategy, finances, and organization, and just as important, they understand the dynamics and the expectations of the board. And of course, some have already been CEOs of other companies, which gives them an advantage.

The worst-performing CEOs turned out to be a group we call insider-outsiders, outsiders who are hired into a company as president or chief operating officer and promoted to CEO within 18 months. HR directors have favored this approach, and in theory it makes great sense: The candidate has a chance to get acclimated to the culture, learn the company, and settle in before ascending to the top job. But the approach often sets the new leader up for failure. The two-step succession process requires the candidate to "audition" for the top position while serving under the incumbent CEO, and that tends to makes him or her beholden to the current chief executive. What's more, the sitting CEO remains the primary conduit to the board, making it more likely that the outside hire will play things safe and be deferential to the status quo. Ten insider-outsider CEOs were appointed between 2004 and 2008, and our analysis found that none of them achieved top-quartile performance.

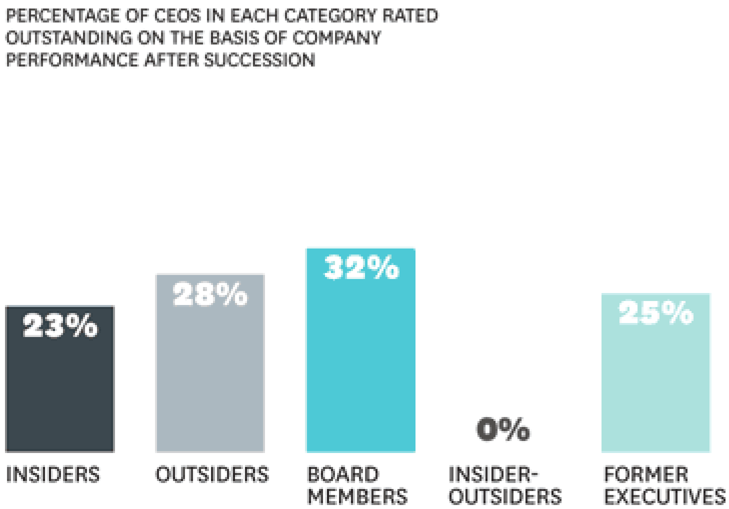
Our research also found that many of the criteria boards use to evaluate CEO candidates turn out to be unimportant in predicting performance. These include candidates' ages, where they went to college or grad school, what degrees they earned, whether they needed to relocate or commute to take the job, or whether they began their career at a blue-chip company. Boards should ignore those variables; they simply don't correlate with performance.

In our view, the most important factor in determining which type of CEO candidate to select is the health of the company. Insiders are best when the company is performing well; outsiders do better when the company is in crisis. This may be intuitive, but when we've shown this data to board members, they're surprised by how compelling the numbers are.

What's the Best Route to the Top?

There are no hard-and-fast rules about which types of candidates make the best CEOs. But our analysis found some solid trends. Among them: Board members shouldn't be a last resort, and "insider-outsider" candidates (who are hired from another company and apprentice under the outgoing CEO before taking over) rarely bring success.

Outstanding Performers




**Insiders: Robert Iger, Disney.** For years Michael Eisner resisted finding a successor, but since Iger took over in 2005, he's led acquisitions of Pixar and Marvel, embraced technology, and renewed the firm's commitment to storytelling.

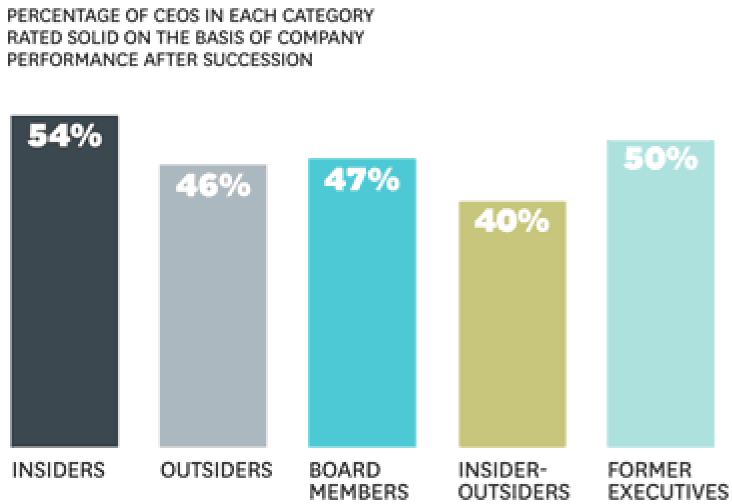
**Outsiders: William D. Perez, Wrigley.** After stumbling as an outsider at Nike, Perez became the first non-Wrigley family member to lead the chewing gum company. Within two years of becoming CEO he negotiated Wrigley's sale to Mars, earning shareholders a 28% premium.

**Board Members: Delta Airlines.** Gerald Grinstein, a former railroad CEO and Delta board member, served from 2004 to 2007.

**Insider-Outsiders: 0%.** In theory, insider-outsiders should work really well, but in practice they don't. Their apprentice role makes them too deferential to the incumbent CEO and too invested in the status quo.

**Former Executives: Charles R. Schwab, Charles Schwab.** Like Steve Jobs, Howard Schultz, and Michael Dell, Schwab is a founder who returned as CEO when his company hit hard times. From 2004 to 2008, he led a near-perfect turnaround and groomed a new successor.

Solid Performers

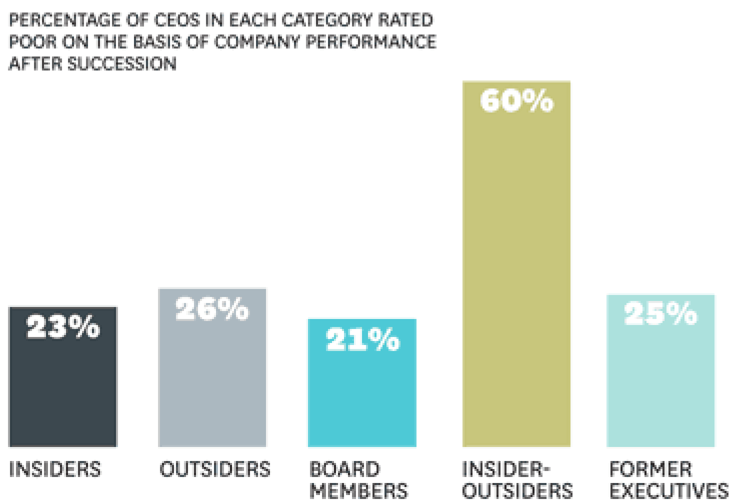



**Outsiders: Starwood Hotels.** Frits van Paasschen, former CEO of Coors, had no hotel industry experience.

**Board Members: James McNerney, Boeing.** He was CEO at 3M and a director at Boeing when the airline manufacturer's chief resigned following a sex scandal. McNerney took over in 2005, winning solid reviews despite delays on the Dreamliner 787 program.

**Former Executives: John Mack, Morgan Stanley.** Pushed out in 2001 by CEO Phil Purcell, Mack returned in 2005 after Purcell's management style led to a talent exodus. Mack, who retired in early 2010, steered the bank through the financial crisis.

Poor Performers




**Insiders: Philip Schoonover, Circuit City.** He presided over the chain's demise, resigning six weeks before it filed for bankruptcy. Most notable move: laying off the chain's most experienced sales associates, which hurt customer service.

**Outsiders: 26%.** When outsiders are hired to lead healthy, growing companies, they underperform, partly because these companies often have strong cultures that are slow to accept newcomers.

**Insider-Outsiders: Sears.** Aylwin Lewis oversaw the merger with K-Mart and ran Sears until 2008.

The leadership challenges presented by a stable, growing company are fundamentally different from those faced by an organization in trouble. Of the 300 transitions we studied, 218 involved companies that were stable or growing, and in that situation, boards chose insiders more than three-quarters of the time. Those insider appointments, in turn, were three times more likely to achieve outstanding performance than the outsider appointments. When outsiders were hired into healthy companies, they were twice as likely as insiders to suffer poor performance.

Why do insiders do better at healthy companies? For one thing, companies that are doing well tend to attract strong talent in the first place. They also have more resources to invest in management development. High-performing companies often develop cultures that make it difficult for outsiders to fit in, partly owing to longtime employees' suspicion over whether an outsider can adapt to company values. The boards of healthy companies are more apt to devote sustained time to the work of leadership development and succession, because they're less busy putting out fires.

When a company is in crisis, however, the data overwhelmingly show that outsiders outperform insiders: The CEOs in our study achieved outstanding performance at three times the rate of insiders. That's because insiders are more likely to be captive to the culture that got the company into trouble in the first place, while outsiders bring a fresh perspective and have more freedom, even permission, to implement big changes.

Examples of how the health of the company should lead the board to look inside or outside abound. At Disney, longtime executive Robert Iger succeeded Michael Eisner in 2005. Despite the boardroom drama that accompanied Eisner's exit, Disney was fundamentally healthy, and as an insider Iger has proved to be the perfect pick. His rededication to storytelling, transformative acquisitions of Pixar and Marvel, embrace of technology, and strong team-building skills have helped Disney outperform rivals in a tough economic climate.

In contrast, consider Philip Schoonover at Circuit City. Hired away from Best Buy in 2004, he served as merchandising chief and president before ascending to become Circuit City's CEO in 2006. By then Circuit City was in tough shape, with Best Buy and Wal-Mart stealing market share, but Schoonover failed to aggressively shift strategies. To cut costs, he laid off 3,400 of the chain's highest-paid (and most experienced) sales associates, a move that backfired as customer service plummeted. He resigned in late 2008, and a few weeks later, Circuit City filed for bankruptcy. For a company that faced such profound challenges, the fresh perspective of a true outsider may have been a better choice.

CEO selection will always be part art, part science. This data can help guide boards' choices. But the process also relies on intuition, and even experienced directors can make the wrong call. A few years ago, our firm placed a CEO at a large technology company. We did all our due diligence and believed he was the perfect leader for the job. Soon after he was brought in, however, he began speaking disrespectfully about his predecessor. He quickly launched a hit new product largely developed under the former CEO's watch and then took a disproportionate amount of credit for it. He performed very well for a time, but he wasn't able to get the company to innovate or reignite its product development pipeline. Within a couple of years, the wheels fell off and he tendered his resignation. It's a sobering reminder that even as boards have become far more engaged and effective in succession issues, making the right decision can still be very challenging indeed.

**LOAD-DATE:** November 1, 2010