

# Do You Have A Plan For Finding Your Next CEO?

By Stephen A. Miles and David F. Larcker

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**Some of our largest public companies harbor a dirty little boardroom secret—their boards of directors have done shockingly little to assure sound, effective CEO succession. Research by Heidrick & Struggles finds boards often have vague succession “plans,” or are overly optimistic about the ability of CEO prospects to step up to the role. Plus, their top candidates may not even know about (or want) the job.**

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In the spring of 2010, we conducted a survey of executive officers and directors of major U.S. and Canadian firms, both public and private companies. Our objective was to determine the state of CEO succession planning in companies today. We received 140 responses—19 percent CEOs, 20 percent chairmen/lead directors, 50 percent outside directors, and 11 percent other positions. A wide range of industrial sectors were represented; small, mid-cap, and large-cap were included. The typical respondent had been involved in a CEO search and/or had been personally considered in a CEO search.

**We found that even the most rudimentary CEO succession planning is still not happening in many companies. Many firms have zero candidates who are ready, or even viable.**

We expected to find evidence that companies engage in real operational succession planning, and that boards and CEOs demand formal internal talent development processes. To our surprise, we found that even the most rudimentary succession planning is still not happening in many companies. When it is happening, it clearly is not having the desired effect of developing truly viable candidates who are prepared to assume control.

Instead, succession planning appears to be compliance-based or little more than “names in a box.” This is dangerous. Compliance-based succession planning creates a false sense of security that leaves companies ill-prepared to deliver viable candidates when the company requires them.

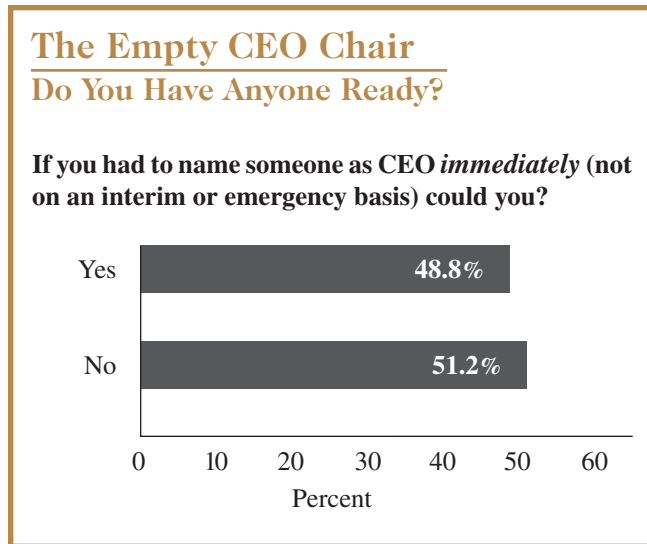
At the onset of this study, one director asked us if this research was some kind of “joke.” Clearly, this director suggested, we had better things to do with our time in the post Sarbanes-Oxley era, in which “all” boards do some form of succession planning. This preconception validates our belief that compliance-based succession planning creates false security.

It is difficult to believe that a board can do appropriate succession planning by spending two hours a year on the topic (as we found in our survey). Despite claiming they are comfortable with their succession planning, board members do not consistently rate their own process as “excellent.” Many firms have zero internal candidates who are ready, or even viable, for the CEO position.

Another striking finding is that boards have not historically recruited directors with deep succession expertise. The nominating and governance committee is often chaired by someone who has never been a CEO before, or who has never been involved in a succession. We recommend that boards staff this committee with people who have relevant experience. This will introduce a new candidate pool of potential directors, including current and former heads of Human Resources and succession experts. These professionals would bring important skills and experience that complement those of the rest of the board.

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We found many additional gaps in CEO succession planning as practiced by boards today. Unfortunately, these myths and assumptions shared by many boards place companies at risk. This points not only to current lapses in the talent pipeline, but also to a lack of readiness should something happen to the sitting CEO. The lack of truly operational succession plans poses unnecessary and entirely preventable risk—risk that best-practice succession planning can mitigate.

**Moving from compliance-based succession planning to a truly strategic plan demands that board members become active participants in developing viable candidates.**

□ *The myth of “ready now.”* Most board members expect the new CEO to be “ready now.” This is defined as “fully prepared to take over,” “having the ability to step into the shoes of the CEO with the ability to work effectively with all constituencies,” and “able to lead and address all opportunities/challenges facing the company in the next 12-18 months.”

However, the notion of the “ready now” candidate is somewhat unrealistic, and should be eliminated from the succession lexicon. Very few people are ever “ready now” for a new position. This is certainly the case of the CEO role. Instead, candidates should be evaluated in terms of their viability. This will focus the board on the risks and benefits associated with

each candidate. It will also reframe the succession process as a risk management exercise that involves planning for adverse outcomes.

The first question a board should ask is, how strong or weak is the “system” we plan to place a new candidate into. The selection of a CEO needs to be made in the context of the strength of the top management team, the state of the company, and the external environment. Also, are there are other moves that can be made to eliminate some risk (such as separating the chairman and CEO roles)?

As an example, consider the case of a Fortune 25 company that was in the process of replacing its CFO. The CEO assessed internal candidates, and also performed an external search to develop a list of the “who’s who” of global CFOs. The CEO asked us to write the business case for whether he should go with his internal candidate or someone from the external list.

The inside candidate had spent the majority of his career in corporate finance and had not been rotated to other functional positions. Moreover, this prospect would not make anyone’s list for this high-level position.

Nevertheless, our recommendation was to choose the internal candidate. The CEO had led the company with a heavy emphasis on financial mechanisms, and needed someone with in-depth financial knowledge and an analytical orientation. To offset the lack of functional background of this candidate, two people were rotated into corporate from the field. More risk was justified in this case because of the core financial strength of the CEO, and a “system” that provided additional experience around the new CFO.

Moving from compliance-based succession planning to a truly strategic and operational plan demands much from the CEO, the head of human resources, and the individual members of the board. Board members become active participants in developing viable candidates. They attend strategy workshops and all-hands meetings, invite candidates to “fireside chats” after board meetings, and spend one-on-one time with key successor candidates. This gives directors direct insights into the strengths and capabilities of C-level and below C-level executives.

**Assess CEO prospects against the future needs of the company, instead of comparing them to each other or to the current CEO.**

□ *Do you know what the next CEO should look like?* When we begin a new succession process, it often goes one of two ways. If the company has a very successful CEO, the board asks us to find another one just like him or her. If the current CEO has not been successful, the board asks us to find someone different.

Neither of these approaches is correct. Candidates should not be benchmarked against the outgoing CEO. Instead, they should be benchmarked against a “skills and experience profile.” This profile is a detailed document that outlines the experience and behavior required of the new CEO based on the future needs of the business.

By developing a skills and experience profile, the board becomes invested in the process. They also commit to and take ownership of key criteria that will later be used to make a decision. This helps tremendously when you get to selection time.

Additionally, the foundational assessments of internal candidates can then be used to assess these prospects against the future needs of the company, instead of comparing them to each other or the current CEO. This helps tone down the notion of a “horse race,” and the process can be managed as part of overall risk management. Unfortunately, our survey indicates that 50 percent of companies do not have such a skills and experience profile.

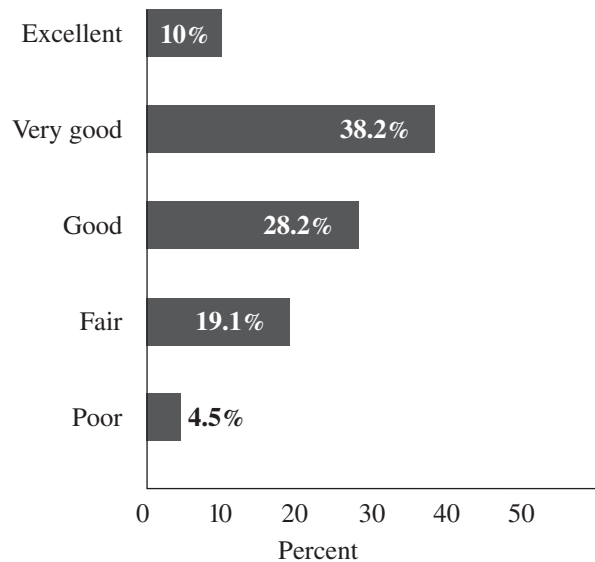
□ *Where is the pipeline?* Boards and CEOs need to develop a succession plan that includes an emergency candidate in the case of a catastrophic event (in our survey, 70 percent of firms have identified an emergency candidate). This is often the chairman/lead director or CFO, and is often someone who is not a long-term candidate for the CEO role (only a candidate in 32 percent of firms).

Additionally, it is necessary to develop a succession pipeline that looks out one, three, five, and seven years. This ensures that more junior candidates are also developing their viability in the eyes of the board. “Pipeline development” is not simply working

## False Confidence

### Your System May Fail When Needed

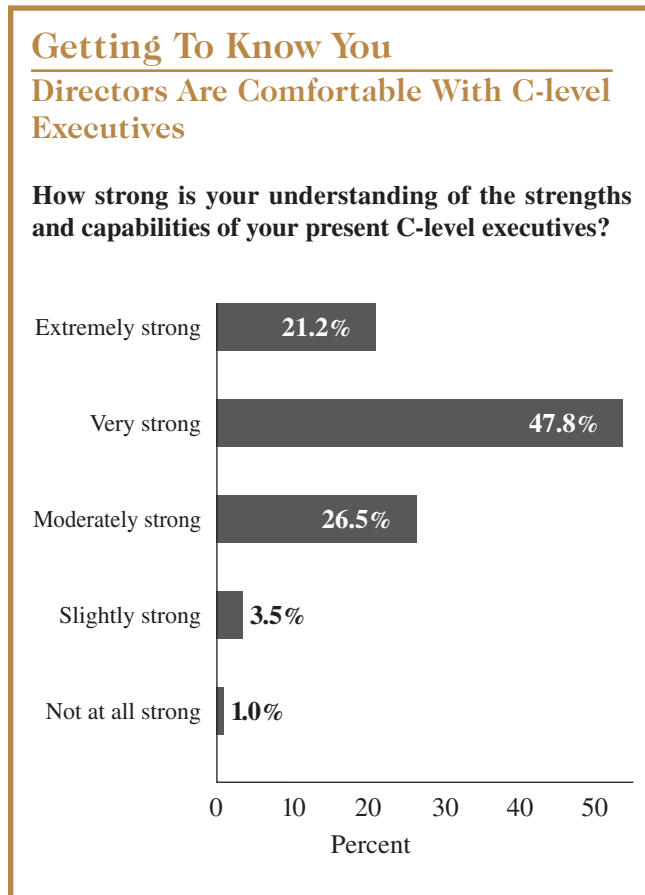
**How would you rate the overall succession planning at your company?**



with individual executives. It involves developing a program to ensure that there is significant exposure with board members beyond the usual PowerPoint presentations.

One of the most important elements of creating viable candidates is willingness to move aside executives who are “blocking” the natural process of succession. Many companies are reticent to do this and as a result, they often never actually move beyond compliance-based planning. Fortunately, there are exceptions. Two years out from a scheduled succession one of our Fortune 50 clients transitioned three executives out of the top management team in order to make room for the succession candidates.

The board and CEO made the succession plan operational by having the courage to cause some instability in the top management team. This exposed the candidates to new roles and gave them a place at the executive team level. This transformational experience resulted in three viable internal candidates at selection time. This is a far easier risk to the management team than not having any viable



succession candidates. Succession planning needs to be done in an active and deliberate manner in order to avoid unplanned firefights and the associated disastrous outcomes.

Companies that succeed at succession planning recognize that it is not a “single person” event. The company needs a CEO, but also must establish bench strength in underlying executive positions. As such, boards are becoming much more interested in learning about the talent that is one, two, and often three levels below the CEO.

These boards apply pressure on the CEO and heads of human resources to have a deeper level of exposure and insight into the capabilities of these rising talents, as well as the corporation’s development plan for them.

*Does your top CEO candidate even want the job?* Many times we are called in to advise a board and CEO on their succession planning efforts, only to find that there has been little or no communication with the key candidates. In some instances, they do

not even know they are a candidate. Others are not even interested in becoming CEO.

There is obviously a lot of risk here, both in terms of how much you reveal to candidates and when you do that. The downside of not revealing anything is that a viable candidate takes an opportunity at another company, disrupting the succession planning process.

One of our client CEOs (who is still in his 40s but has determined that he only plans to work for the next five years) offered complete transparency to his entire leadership team, and walked them through his plans for the next five years. This included telling those that were not candidates that they would be moved into advisory roles two years out to ensure they were not “blockers.”

This is taking transparency to a whole new level, and is not something we would recommend in every case. However, it provides an example of just how transparent some companies are. It also illustrates the value of moving down the path of transparency and away from a complete “black box” where everyone is trying to “read the tea leaves” of succession.

*Does your new CEO get the support he/she needs?* The work of the board is not over after they make a CEO selection decision. Unfortunately, we find that “on-boarding” (a detailed transition plan for the first six to 12 months) is done in only about half of our survey companies.

We do not buy into the notion of the “first 90 days.” We believe this leads to behaviors that can cause a new CEO to derail, as this artificial time construct can cause them to do things they would not normally do. Instead, think of a CEO transition as the first 12 months. The CEO should break this down into quarters and then identify short, medium, and longer term opportunities.

The CEO should be assessed at 6 and 12 months, providing the board with a full update on progress and the CEO with key transition data. Both should know what is working, and be aware of any issues that may be arising.

**Most boards still have a long way to go managing the disruption caused by CEO turnover.**

Most companies and their boards still have a long way to go on managing what can be one of the most disruptive corporate events—CEO turnover. A minimal, compliance-based plan ignores current talent, strategic corporate objectives, and the overall context of what the company truly needs.

Our findings point to the need for clear best practices that will elevate succession planning to become an integral part of leadership strategy for both the immediate and long term. These include:

- Move from compliance-based succession planning to a truly strategic and operational succession plan.

- Add succession expertise to the board. This could include looking at new pools of talent, such as current or former heads of human resources, succession experts, etc. Make sure that the director chosen to chair the nominating and governance committee has previous succession experience, either as a candidate or as someone who has run the process.

- Think of succession planning as a multi-person event versus “we need to select a CEO.” The executives that are not promoted to CEO are also crucial to success and the creation of shareholder value.

- Develop a succession architecture that encompasses everything from an emergency step-in through a more gradual, five-years-out succession. Ensure that the board frequently revisits this architecture, including the emergency plan, to ensure that candidates are appropriately progressing along the board’s timelines.

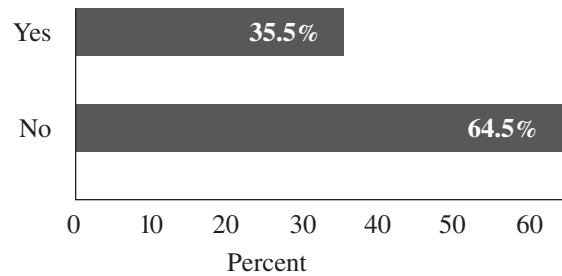
- Develop a skills and experience profile that takes into account the future needs of the company. The board should also continually revisit this profile at various stages to ensure that it is still “on track” with the company’s needs.

- Engage the board to ensure the development of “viable” candidates. Use external advisors to assess and benchmark the internal candidates against the marketplace, as well as provide ongoing coaching, support, and updates to both the candidates and the board. Communicate with potential candidates to

## Who, Me?

### Does Your Candidate Even Want The CEO Job?

Have you asked internal candidates whether they want the job and will they accept if it is offered to them?



reduce retention risks.

- Look at the top team structure, identify “blockers,” and prepare to move people off of the senior team to further develop potential successors. Develop retention strategies for the team, and ensure that you are also developing “up and coming” talent so that you have succession plans in place for members of the senior team throughout this transition process.

- Expose the board in different ways to the candidate pool (fireside chats; a board member attending an executive’s off-site sessions; one-on-ones or two-on-ones for dinner). Also consider generally immersing the board deeper into the talent levels of the company.

- Engage in a confidential external search so that the board can compare internal candidates against best-in-class talent in the marketplace. The general rule is that to be “viable,” an external candidate must be at least 1½ to 2 times better than the internal candidate.

- Ensure that the newly selected CEO has a first year transition plan that includes updates to the board of directors at 6 and 12 months into the job.

- Provide the new senior team with ongoing coaching and support. ■