

A Higher Order of Thinking

Albert Einstein reportedly remarked that “it takes a higher order of thinking to solve a problem than it took to create it.” For most boards, often the most difficult and, without doubt, important issue is succession planning. Recent events on Wall Street only underscore this reality.

There are a number of circumstances under which directors must decide how to respond when the situation indicates that their organization needs a new CEO. This can happen because:

- The CEO decides to retire or not renew at the conclusion of his or her contract.
- He or she is suddenly and unexpectedly unable to continue in the role due to sickness, death, or other unexpected circumstances.
- The CEO accepts another position.
- The board determines that the CEO does not have the right mix of skills, abilities, personality, and values to cope with current challenges.

Regardless of the reason, boards need to be prepared for the possibility that they no longer have the right leader.

Many directors are, or have been, CEOs at other companies. Many of them reached their positions from outside the company with the aid of an executive recruiter, so it is quite understandable that some may harbor thoughts along the following lines: “Since this approach has worked for me in the past, it can certainly work again here if something comes up that requires us to remove the current CEO.”

Depending on the situation, this line of thinking may actually be correct—an outside candidate who fits the company culture may be just what is needed to address the needs at hand, especially if the company has been suffering from stagnant thinking. Today, 37 percent of *Fortune* 1000 companies are run by executives recruited from the outside. Going outside, however, will not necessarily produce positive results. According to the available data, there is no statistical correlation between achieving success as a CEO at one company and doing so again at a new one. In fact, according to a 2005 Booz-Allen-

Hamilton survey, CEOs who had successfully headed up publicly traded companies previously and were subsequently recruited to new public companies actually delivered slightly worse returns to investors in eight of the nine years studied (1997–2005). That same study also showed that while outside CEOs excel in the short term, insiders performed better over the long term.

The CEO turnover rate has escalated rapidly in the last 10 years. A decade ago, the rate at which senior executives were terminated was a mere 4 percent per year. In 2007, it was 14 percent—3.5 times higher than the prior decade’s average. But while the rate of CEO departures has increased, the way in which new CEOs are selected has not changed appreciably. Perhaps if boards were able to do a better job of selecting the right CEO for a particular situation in the first place, the problems of replacing the CEO later would be reduced.

The traditional selection process that has been used by most companies lacks steps to gather and analyze substantive, empirical data about the true needs of the company and about the various cultures in which the new CEO will be enmeshed. As a result, directors have achieved the dubious distinction of knowing when to terminate a failing CEO, but have had measurably less success in finding the right replacement. As executive advisor Ram Charan puts it, “The problem isn’t that more CEOs are being replaced. The problem is that, in many cases, CEOs are being replaced *badly*.”

In 2006, the National Association of Corporate Directors published a Best Practices Study pertaining to the role of the board in CEO succession planning. It identified 10 best practices recommended to directors at that time. (See “Best Practices,” page 62.)

In addition to these 10 best practices, the NACD study also described nine basic steps that constitute the essential events in a thorough CEO succession-planning process.

Using this succession-planning process as a framework, 15 enhancements to best practices for boards

Successful succession planning assesses of the needs and culture of the organization.

By Nat Stoddard and Claire Wyckoff

In Practice | Succession

Best Practices Succession

1. Plan 3–5 years out.
2. Ensure full board involvement.
3. Establish an open and ongoing dialogue and an annual review.
4. Develop an agreed-upon set of selection criteria.
5. Use formal assessment processes.
6. Interact with internal candidates.
7. Stage succession, and avoid horse races.
8. Develop internal candidates rather than recruit externally.
9. Have the outgoing CEO leave right away or stay on as chair for a limited time only.
10. Prepare a comprehensive emergency succession plan.

SOURCE: NACD 2006

embarking on the development of a CEO succession plan are detailed here.

Step 1: Set the Stage for CEO Succession

Best practice enhancement: Engage an outside planning consultant.

As you set the stage for succession planning, identify an outside planning consultant who can serve as the board's special advisor throughout the process. The board's consultant should be experienced at managing projects with this degree of complexity, sensitivity, and confidentiality. To ensure objectivity and clarity of counsel, it is essential that the board's advisor have no ties to the internal candidates or to the company's culture.

Step 2: Establish a Timeframe for the Process

Best practice enhancement: Conduct timely research and analysis of needs and cultures.

Ensure that adequate time is allotted to gather the factual data needed at critical points in the process. It is recommended that a qualitative team assessment and a quantitative cultural assessment be prepared at the earliest stages of the process for benchmarking purposes and also for use in the event the current CEO encounters health or other problems requiring immediate action on behalf of the board. In the case of the planned retirement of the CEO, the essential fact-finding research and analysis work can be conducted just prior to initiating the selection process. The research and analysis can also be conducted concurrent with the process if an unforeseen change is required.

Step 3: Develop Criteria for the Future CEO

Best practice enhancement: Define success criteria in terms of actions, not outcomes.

This is where an in-depth assessment of the needs of the company is absolutely essential. Without knowing what actions are required to achieve the desired results, it is not likely that an optimal match of abilities, personalities, and energy needed for the job will be achieved.

Step 4: Source Candidates—Internal vs. External

Best practice enhancement: Use executive recruiters for what they do best.

Clearly define the role of the executive search professional who is chosen to source external candidates and to interview internal ones. Ensure that the same research and analysis of the needs and the cultures of the organization are understood by the search executive(s) involved in the process (as well as everyone else on the selection committee).

Step 5: Understand the Talent Pool

Best practice enhancement: Conduct interview training.

Conduct behavioral-based interview (also called Behavioral Event Interview or BEI) training for everyone on the succession-planning team who will be called upon to interview candidates in the leader-selection process. This technique will produce the greatest insights into the relevance and true nature of the candidate's experience.

Step 6: Assess the Candidates

Best practice enhancement: Use BEIs to get to know candidates' abilities, personalities, style, energy, and character.

Use appropriate assessment tools to gain better insight into each candidate's personality and values. Use a character interview conducted by the individual to whom the new CEO will report (i.e., the chairman or lead director). The alignment of the selected leader's values with those of the organization is essential to building organizational trust, loyalty, and followership.

Step 7: Develop the Candidates

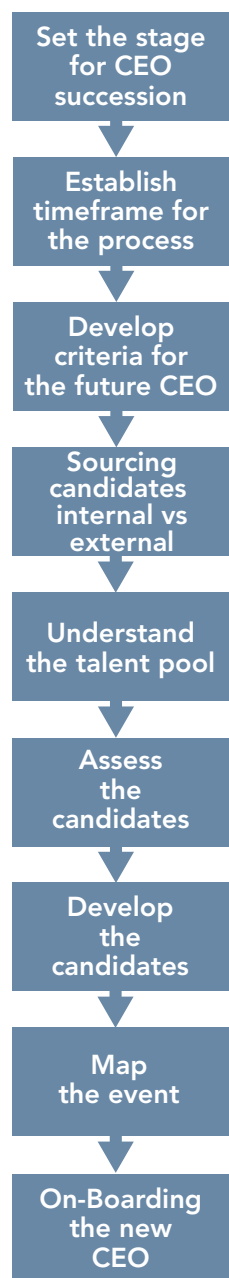
Best practice enhancement: Use assessment tools to identify development gaps.

Use the information gathered from the candidate assessment process and the company's research of its needs and cultures to identify specific development needs of each internal candidate. Review their deficiencies with the candidates and formulate plans to provide experiences to close the development gap.

Best practice enhancement: Measure progress on a regular basis.

Ensure that a "scorecard" identifying the individual's specific development needs is completed periodically and reviewed with the head of the selection

Nine Steps to CEO Succession Planning



SOURCE: NACD

committee and the individual every six months. This measurement of progress helps avoid surprises at the end of the process and maintains a more objective focus on very personal agendas.

Best practice enhancement: Cast a broad feedback net about the candidate.

Establish a procedure requiring each director who has contact with an internal CEO candidate—regardless of whether it’s in conjunction with an assessment interview, a social event, or a regular part of director-executive interaction—to provide feedback indicating how the director evaluated the candi-

team assessment analysis, the succession-planning consultant should be ideally positioned to serve as the on-boarding coach for the selected individual. The development coach who has worked with an internal candidate may also make an excellent on-boarding coach, depending upon the coach’s business background and skills.

Best practice enhancement: Solicit feedback for continuous improvement.

All candidates—internal and external—who have come in contact with the selection-planning process at any point in time should be notified of the outcome

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date on those specific points the individual is working to improve.

Step 8: Map the Event

Best practice enhancement: Use your planning consultant as a project manager.

As the time approaches to activate the leader-selection process, utilize the outside succession-planning consultant to drive the process, taking the coordination of schedules for all interviews out of the company’s offices for greater security and anonymity of outside candidates.

Best practice enhancement: Provide a “clearinghouse” of information for candidates.

Give each internal and external candidate the telephone number and contact information of the administrative assistant to the board’s planning consultant as the “central clearinghouse” for questions and concerns that may arise during the process.

Step 9: On-Board the New CEO

Best practice enhancement: Use data gathered to select the CEO as a basis for the transition plan.

Beginning the development of the new CEO’s “first 100 days plan” upon his or her arrival is at least 100 days too late. By using the research findings from the needs and cultural assessment work as well as the

of the process and should be requested to provide anonymous and confidential feedback about their experience, treatment, and perceptions, and share suggestions for future improvements to the process through the board’s independent planning consultant.

Making a poor decision around CEO succession is incredibly costly. Our work in this area indicates that, depending upon the size of the organization, the cost of replacing a failed CEO after only 18 months on the job ranges from an average of \$13 million for small-cap companies (\$300 million to \$1 billion) to \$53 million for large-cap firms (greater than \$4.5 billion). But these amounts pale in comparison to the impact that most leadership changes have on a company’s organization, stock price, and volatility.

A better approach to selecting the right leader may very well be the way to solve some of the costly leadership failures so prevalent today. And to improve the efficacy of CEO succession planning, too. **D**

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