



[Blogs](#) / [2009](#) / [February](#)

## Playing By the Numbers—Reducing the Costs of Leadership Failure

Playing By the Numbers—Reducing the Costs of Leadership Failure

[Compensation](#), [Compensation Trends](#), [executive compensation](#), [Severance Pay](#)

Posted by [Stoddard, Nat](#) at Tuesday, 02/03/2009 10:21 pm

Co-authored by Claire Wyckoff and Nat Stoddard

When Bob Nardelli was ousted as CEO, it cost Home Depot \$210 million. Pfizer gave Hank McKinnell a \$123 million package, Gary Forsee received \$40 million from Sprint, Carly Fiorino, \$23 million from Hewlett Packard, and Richard Grasso, a highly controversial \$188 million from the New York Stock Exchange. While not as impressive as the headline “funny money” payments to a handful of executives, the authors’ experience with hundreds of senior-level executives’ severance provisions indicates there is still cause for considerable concern.

Indeed, our experience has led us to research the issue further and to start developing new processes for reducing the rate of turnover in the C-suite. Here is brief outline of what we’ve learned.

In 2007 our compensation consultants informed us that the average total cash compensation (including bonuses) for CEOs of large-cap (revenues greater than \$4.5 billion) was \$1,650,000. Using a multiplier provided by The Corporate Library the customary severance most large-cap companies pay a departing CEO would be around \$5 million. However, it has been our experience that most CEOs of mid-cap or smaller corporations receive lesser severance packages. Using a smaller multiplier and lower average total compensation figures for these groups, the average severance payments would be closer to \$1.7 million and \$650,000 respectively.

These costs would not be so noteworthy if turnover rates in the executive suite weren’t escalating. However, according to Challenger, Gray & Christmas the number of CEO departures in the United States for the three-year period from 2005 to 2007 averaged nearly twice that of the preceding three years. By mid-year 2008 the turnover rate was again on the increase, with departures 7% above the level reached in the same period of 2007.

Furthermore, severance costs are not the only costs to the company that are incurred when a CEO failure occurs. There are numerous direct cash costs related to finding and onboarding the executive’s replacement, as well the replacements of the 25% of executives who will on average leave the company after a new CEO is brought in.

Then there are other, non-cash costs that occur when the CEO fails to deliver the expected results. For public companies, one such cost that’s extremely important comes from the stock market’s reaction to

the change. Yet another cost attributable to a failed leadership change comes from all the opportunities missed because it went leaderless if even for a short while.

Trying to isolate and measure the financial impacts to the organization of all these direct and indirect factors on a meaningful basis is a challenging exercise because there are so many moving parts. However, we've been able to integrate analyses done by other authorities in the field with current data and concluded that the financial cost of having the wrong CEO at the helm, even for just 18 months, can range between \$12 million (for small-cap companies) and \$50 million (for large-cap companies).

Finally, and perhaps most important, the effects of a failed leadership transition are not limited to just the company and its shareholders. Leadership failures have a long-lasting, sometimes permanent, impact on the lives of the people affected. Companies do not have feelings; they do not grieve; they do not have to fight to carry on in the same way the failed leaders do. Even if they negotiate a large package, the loss of status, power, and reputation is often so great that some executives never recover from the experience. Moreover, the trauma to the failed leader can easily be overshadowed by the impact on the hundreds, or thousands, or even tens of thousands of other people affected by a single leadership failure, which is often where the greatest effects are felt.

Of course today's company tries hard to guard against this damage. To help ensure we have found the "right" leaders, we put candidates through extensive interviews, in-depth background checks, and even psychological and behavioral assessments. We show that our understanding of what it takes to be a leader has been expanded greatly, and we employ that knowledge to scrutinize candidates more closely. We have done little, however, to change how we view the job these new leaders will fill and the context in which those jobs must be carried out. While the world has changed—the risks and costs and likelihood of leadership failures have changed, and the expectations, timetables, and the complexities of the jobs have changed—beyond looking more closely at the candidate, the Traditional Selection Process has not kept pace. As always, this process still focuses on selecting the right "peg" with little, if any, effort made to first understand the specific shape and nature of the "hole" into which the peg is supposed to fit.

When you look at the outline of the Traditional Selection Process below, you'll discover that nearly every step in the process, including onboarding, is focused on the individual:

### ***Traditional Selection Process***

- Job Description - Deliverables, Skills, Behaviors
- Define types of organizations to target
- Review potential internal candidates
- Commence external search
- First "sighting" candidate
- Long list discussion of potential candidates
- First short list interviews
- Second short list interviews if required
- Final candidate interviews
- Offer, negotiations and acceptance
- On-boarding coach assigned & first meeting

- Internal announcement
- Commence work

Conversely only one of the eleven steps—the job description—even attempts to analyze the realities of the business situation that will determine what the right candidate will have to accomplish.

As part of a career transition and outplacement team that works with senior executives, one of our observations is that the job specs for senior positions are largely identical. There are several reasons this is true, the two most compelling of which are that:

- The people who know the most about the new leader needs to do to deliver the desired results—namely the direct reports of the new leader—are rarely asked.
- The deliverables are based on experiences and perceptions, not on hard facts expressed in terms of the specific *actions* required to produce these outcomes in a particular situation.

The net result may be a story such as this one told to us by one outplacement client:

#### Identifying the Real Needs

A few years ago, our company was brought in on a consulting assignment by a NYSE-traded corporation while the search for a new CEO was underway. According to the position specifications developed by the head of HR in collaboration with the executive recruiter, the lead director, and the head of the board's search committee, one of the key attributes that the new CEO would have to possess was "strong experience dealing with sales organizations and their restructuring." The reason for this spec was that the board suspected systemic problems existed in the sales organization. When we looked at the company's sales performance for the previous three years, their concern seemed quite legitimate and their conclusion understandable. Sales had been basically flat for three years while previously the same field sales organization had delivered consistent growth above the industry average. This was no small feat since they were the dominant player in their industry. Clearly something had to be done to get sales growing again. Based on the perception of the board, that would entail restructuring and replacing a lot of people. They wanted to be sure that their new CEO was no stranger to this kind of work.

When we conducted our interviews with the people closest to the work, however, a very different picture began to emerge. As it turned out, the sales force had the enviable reputation of being the best trained and most disciplined of any in the industry, and the company was highly respected for its service delivery. Furthermore, every one of their competitors' top sales executives had, at one time or another, come from my client's company.

At first the pieces did not fit, but as we kept digging, we eventually got to the crux of the problem. In three of the preceding four years the former CEO had insisted on changing the sales compensation plan in an attempt to achieve alignment with that year's management directives! One year, the sales goals were based on obtaining new dealers; the next, they were based on selling new products; in the third, the incentives were intended to stimulate customer retention and increased sales through existing accounts. Since these changes were developed at the initiative of the CEO, it was self-defeating for him to go to the board and admit that, "Oops, I shouldn't have been trying to drive short-term results in a

long-lead time business.” Neither was the head of HR inclined to point at the numerous changes to the comp plans since he was their architect; he just went along with the board’s view of the problem while developing the position specs for the new CEO. As a result the board focused on other reasons for the poor sales performance. Meanwhile, with all the changes thrown at them, the sales team did not know whether they were on foot or on horseback.

Fortunately, as a result of our findings, we were able to eliminate the requirement that the top candidate possess a heavy sales background, allowing another candidate—one who had leadership traits and background experiences that were more aligned with the true needs of the company—to get the nod. Over time, he proved to be the right person to make the changes that were really needed. These included stabilizing the sales compensation plans. By focusing on the real needs instead of the perceived needs, less time was required to reenergize the existing sales team than if restructuring the field sales organization had been pursued. A disaster had been averted.

This is one of many experiences that support our contention that the current hiring process often fails to account for the true needs of the situation. None of the steps incorporate rigorous “fact-finding” or bona fide research to verify what things *really* need to change and which changes should come first. Nor, as in the case with my client described previously, does the Traditional Selection Process identify those things that should be left alone.

Now if you look back at the Traditional Selection steps, there is something else that should be noted—something that is missing entirely. No place in this “peg-oriented” process is there a step to identify anything about the culture of the company overall, or of the culture of the team the new hire is going to lead. Just as importantly, nowhere in this process is there a place to identify anything about the *culture* of the team on which the new leader is going to be a member—the boss’s team.

One way to change the way needs and cultures are addressed in the selection process is to create a new selection model. At Crenshaw Associates, the one we have created is dubbed the “Match-Fit Model.” In the Match-Fit Model, “match” is a function of how well a candidate’s abilities, personality (behaviors), and energy relate to the needs of the company. And the crucial “fit” of the new leader now comes down to a blend of personality (often referred to in this context as “style”), energy, and his or her *character* relative to the culture of the company.

The creation of the model has, in turn, allowed us to make significant modifications in the selection process. Our new Leader Selection Process, not only takes a more aggressive approach to the way needs are researched, it also builds in a plan for researching both the culture of the organization and the way the candidate’s character fits that culture.

Given the continuing failure rates of scores of bright, motivated, and, yes, competent, leaders, we believe it is time for the paradigm to shift. It is time that companies and candidates put as much of the same critical and data-driven effort into understanding the shape of the hole as they do the shape of the peg, realizing that just because the a successful peg fit well with the needs and cultures that shape another hole previously, it was not going to automatically fit into your corporate hole no matter how patiently or how hard it is pushed. As we have seen, trying to jam the wrong peg into the wrong hole has costly and painful consequences for one and all. It is time HR leaders lead the change from the ineffective Traditional Selection Process of old to a newer, more fact-based and data-driven approach,

recognizing that the mantra “If you can’t measure it, you can’t manage it,” that’s so applicable in other corners of business is equally germane to the Leader Selection Process.