



boards of directors have always been responsible for CEO succession planning

# the board of directors' role in CEO succession

Q & A with Heidrick & Struggles

**Q** *What is the board's role in CEO succession planning?*

**A** Boards of directors have always been responsible for CEO succession planning. In fact, the evaluation and selection of the CEO is the board's second most important governance function, after fiduciary responsibility. The best way to handle this critical task is to be objective and thorough. A board that approaches the task wearing blinders, burdened by outdated perceptions, or laboring under unexamined assumptions is not acting in the best interests of shareholders. To be effective stewards for shareholders, the appropriate board committees must partner with an expert advisor to apply a strategic, disciplined and stringent approach to identifying and developing the top executive of the organization.

Boards and CEOs need to have a clear understanding of the leadership talent in the marketplace and the alternatives available in the absence of viable internal candidates. Sound corporate governance suggests that an incumbent CEO would not likely lead an outside search for a successor; rather, an independent director or the head of the Corporate Governance and Nominating Committee would be more likely to take the lead. The CEO working with the board should be keenly aware of the early signs of leadership potential in their top executives and be closely involved in developing the skills and

talents of those people to achieve the long-term objectives of the business. Identifying, assessing and developing leadership potential, as well as building a sustainable leadership pipeline, are critical components of succession planning.

**Q** *How should boards approach CEO succession? When is the right time to do succession planning?*

**A** Any top executive's departure has a significant impact on an organization's strategy, operations, culture, morale and ability to execute against objectives. As boards search for a CEO successor, they must bear in mind that that impact is magnified when the departing executive is the CEO.

The reasons for a CEO's departure generally fall into one of four broad categories:

- 1 The CEO leaves to join another company;
- 2 The CEO retires or takes an extended leave of absence;
- 3 The board decides that the organization requires a CEO better suited for the current environment or for likely changes in strategy or market conditions; or
- 4 The organization's board or its controlling investors decide to dismiss the CEO or are nearing a decision to do so.

These first two reasons could be classified as reactive; that is, the departing executive drives the event and the company must respond in some way. The last two scenarios are typically proactive approaches by the board. Let's consider the challenges and opportunities each scenario presents:

#### REACTIVE EXECUTIVE SUCCESSION

The CEO leaves to join another company; the CEO retires or takes an extended leave of absence.

A board's ability to conduct effective succession planning depends on a variety of factors, but most salient is the amount of time it has to react. A board seldom can identify and enlist a permanent CEO with two weeks' notice. Even two months is questionable. Ideally, succession planning has started months or years before the time comes to replace the CEO. That is the strongest case for succession planning: to increase your time to react and to broaden your portfolio of alternatives.

There are several options for boards when the need to replace a CEO exists, including "going to market" to recruit the appropriate skills and competencies to fill the position, or tapping or developing existing internal talent. Unless strategic succession planning has been in place for a while, boards may have little choice but to recruit an outsider. One of the most compelling reasons for a board to partner with an executive search firm to identify a CEO is the up front needs-assessment review. The board emerges from this broad-based due diligence with an enriched understanding of objectives for the planned organization, the competitive backdrop, and the skills and competencies necessary to lead the company going forward. Using tools to benchmark and assess CEO talent, the process dramatically enhances the board's ability to make an informed choice among outside prospects.

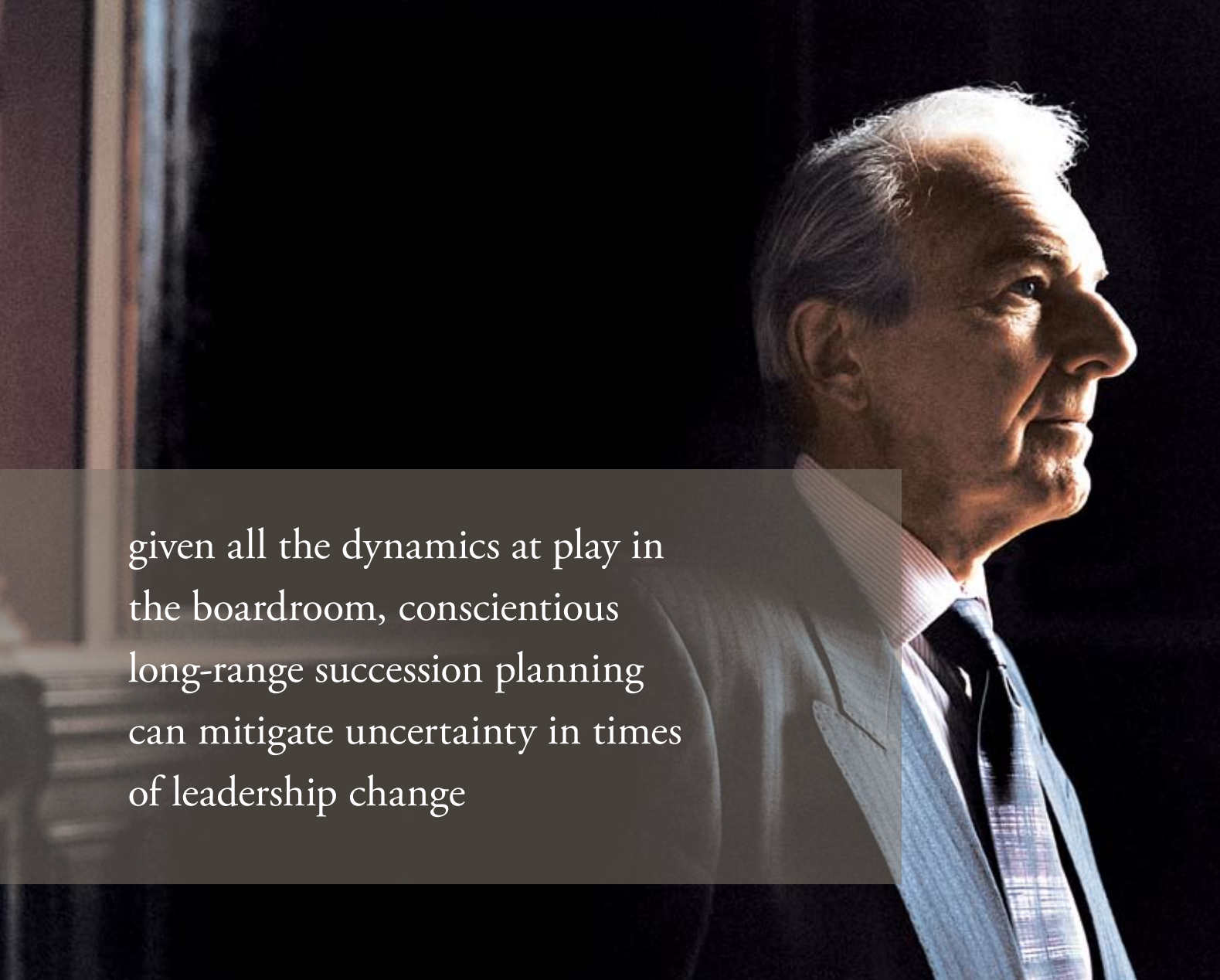
If there are viable internal candidates, boards may choose to invest in developing this talent. Companies lacking adequate internal structures or resources will frequently outsource professional development activities. Boards that intend to develop a CEO internally often promote the internal candidate to a stepping-stone post such as chief operating officer or another top-level position to gauge leadership ability. Other boards may opt to appoint an interim CEO, who may or may not be a current board member. Again, the more time a board has in these reactive situations, the better.

#### PROACTIVE EXECUTIVE SUCCESSION

The board decides that the organization requires a CEO better suited for the current environment or for likely changes in strategy or market conditions; the organization's board or its controlling investors decide to dismiss the CEO or are nearing a decision to do so.

A board member once remarked, "If you don't have time to do it right, how will you have time to do it over?" A board that approaches succession planning years before the anticipated need is clearly on the right path. Taking a proactive stance opens up the board's options as the organization grows (or shrinks), or once the board realizes the need for change.

Quite possibly, the incumbent CEO has been successful up to the present time but is no longer the best person to lead the company in the future. It could be a company's founder who is detrimentally biased by emotion; the CEO of a private company who needs to make way for a professional manager experienced in bringing companies public; the CEO of a growth company in need of a leader familiar with rapid multinational expansion; or a CEO of a company facing unprecedented competitive demands.



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Boards confronting the need for transitional leadership during turnarounds, mergers or acquisitions, IPOs, restructurings or other times of substantial change may turn to an interim CEO. The right interim CEO – tested in crisis and trusted by employees, creditors and shareholders – can steer the company through its volatile period while the search for a permanent successor continues.

Painful and traumatic as it can be, the dismissal of a chief executive can offer business organizations an opportunity to renew and refocus on strategic goals. Some CEOs who can be intellectually and emotionally honest with themselves will recognize that their skills and energy level may be becoming irrelevant to the company's needs. If a CEO does not step aside voluntarily, however, boards must force the issue – something many directors are understandably reluctant to do.

Faced with the unpleasant task of dismissing a CEO, some boards manifest a phenomenon that we refer to as “mismanaging agreement.” Though individually all members may believe that the CEO needs to leave, as a group this agreement somehow becomes obscured and they fail to reach a consensus and consequently do not act. The failure to manage agreement is a major source of board dysfunction. By mismanaging hidden agreement, the board essentially colludes to fail.

Above all, however, a board in denial about the need to replace a lackluster or poorly performing CEO is most damaging. Given all the dynamics at play in the boardroom, conscientious long-range succession planning can mitigate uncertainty in times of leadership change.

**Q** | *What are the general activities in CEO succession planning?*

**A** | We recommend a series of transition planning meetings at which the board navigates through four phases:

- 1 “Letting go,” which amounts to stopping activities that are no longer relevant to the business, evaluating processes that may need to be started, and continuing managerial processes or procedures that are working well;
- 2 Gathering data and discussing objectives;
- 3 Putting short- and long-term plans together and implementing them; and
- 4 Coaching the new executive and evaluating the impact on the company after the executive is placed.

Many boards erroneously believe that succession planning ends with the actual plan. In fact, the plan is just the beginning. There are a multitude of activities to commence from the plan including creating opportunities to groom internal executives, benchmarking talent in the marketplace, and establishing processes that will ensure a successful transition after the new CEO is in place.

**Q** *What are the underlying reasons for a board to use an outside firm to assist in conducting targeted, strategic succession planning?*

**A** Assessing executives' strengths and weaknesses is not a core competency for most corporations. Ultimately, companies and stakeholders are much better served if processes such as executive assessment, executive benchmarking and board reviews are leveraged with expert assistance. When a leadership slot opens, boards want to be sure that they can access the best talent in the marketplace.

Increasingly, companies are building a more strategic human resources group internally to better address the broad array of human capital issues but, to fill the chief executive slot, boards and CEOs need to turn to firms skilled at senior-level executive assessment and succession, much like they make use of lawyers and investment bankers.

**Q** *What is the economic argument for succession planning?*

**A** Most corporate investments currently center around the recruitment, development and deployment of human capital. Regarding CEO succession planning, you have to ask boards today, "What is the cost of not recruiting the best CEO available for your company?" The punitive costs of hiring the wrong person, or promoting an internal executive who doesn't benchmark well against the outside talent, are simply too high in the present business environment. The candid question board members should be asking themselves is, "Have we been as successful as possible given the opportunity we had in the marketplace?" Today's investors expect no less.

Given the intense focus on financial accountability and sound governance, it makes sense for boards to be equally serious about accountability and excellence in the chief executive responsible for the company. Strategic succession planning gives boards ample runway to find the best CEO possible.

