

# Smart Planning For CEO Succession

by Sandra Davis, Ph.D. and David Nosal

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**If “failing to plan is planning to fail,” what does it mean when over 40 percent of major corporations have no CEO succession plan? An effective succession blueprint that is overseen by the board, motivates the CEO, and draws on company talent, can easily be built into corporate strategic planning. This can help strengthen the company’s future.**

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Amid the most challenging economic environment of our lives, shareholders, investors, employees and now even the government is increasingly holding boards accountable for CEO performance. Never has it been more vital to not only have the right CEO in place, but also a sound CEO succession plan.

Along with fiscal oversight, CEO succession planning is one of a board’s two most important responsibilities. Yet curiously, many boards struggle with this inevitable role. In 2008, the National Association of Corporate Directors (NACD) found that 42 percent of companies had no CEO succession plan at all. Further, just 16 percent of directors believed that their board is effective at CEO succession planning.

The consequences of poor CEO selection are presented in the 2009 book, *The Right Leader: Selecting Executives Who Fit*. Some 40 percent of CEOs are fired or “retired” within their first 18 months, and 64 percent of them never make it to their fourth anniversary. The average cost of replacing a CEO after 18 months runs into the millions.

There are many reasons why companies may lack a formal succession plan. In our experience the primary reasons are because the subject seems far removed from the company’s day-to-day business, and directors are uncertain about what steps to take. Thus, board members often either succumb to the temptation of doing nothing, letting precious planning time slip by, or react only to an immediate need, hastily hiring a CEO who may not be the best fit.

Unfortunately, boards often inadequately define how a future CEO should drive corporate perfor-

mance. Boards often think more of *who* to hire (potential candidates they happen to know) rather than *what qualities* to hire (the needs of the company applied to the skills of specific CEO candidates).

CEO succession need not be this way. Instead, boards should focus on the “what to hire” by creating a customized blueprint for their CEO succession planning. This requires specific requirements and attributes for the role, and information on internal and external candidates. This should be collected and analyzed objectively through an explicit, well-defined planning process.

**If the board lacks a CEO succession plan, and directors are forced to quickly select a new chief, an “impulse purchase” that you will later regret becomes more likely.**

A CEO succession plan creates a degree of certainty for all stakeholders that the board is ready to make an informed decision regarding its next CEO. We all like to believe that we make consistently correct business decisions. For decades, economists assumed that everyone makes rational business decisions, motivated by self-interest. However, this mainstream economic theory has been called into question by newer research in behavioral economics.

Researchers have shown how our internal biases cause us to take shortcuts in our decision-making that depart from basic principles of probability. When people lack a systematic way of making a decision, they revert to non-analytical means of decision-making, such as those driven by emotion.

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## Six Barriers To CEO Succession Problems Boards Can Overcome

There are potential barriers that impede boards from properly planning for CEO succession. In order to overcome these, it is important to not only know about them, but also have in place a quality blueprint for CEO selection.

□ *Competing board issues.* Compared to immediate concerns like corporate governance and financial performance, CEO succession planning may seem to some boards to be a less pressing issue. However, even in companies where the status of a chief executive appears rock-solid, the CEO may still hastily depart due to personal reasons or illness. Boards should discuss succession planning at least twice annually.

□ *CEO cooperation.* It can be difficult for many CEOs to move on, particularly for those who have invested a considerable amount of time and effort in the role. Yet this does not mitigate the need. In our experience, the best CEOs are those able to objectively and cooperatively work with their boards to groom and train their successors. Boards can facilitate this effort by ensuring that succession planning is a focal point of the CEO's job description and pay package.

□ *Board complacency and/or objectivity.* Boards often believe that a cursory approach to succession planning is "good enough" until the time is right to make a choice. In today's market, such casual approaches to governance are no longer sufficient. Similarly, boards that believe that they can rely solely on their own subjective assessments of CEO candidates may shortchange the quality of their selection. Qualified, objective external talent counsel can be invaluable for thorough candidate benchmarking.

□ *Inadequate internal talent.* Given the considerable expectations and demands placed on a CEO, it is not surprising that many companies lack viable internal candidates for the role. Boards can help ensure a higher-quality pool of internal talent by expecting the company to have a high-quality leadership development process for its senior executives. This will take some time (months, or even years) to adequately develop. In response to an anticipated long-term lack of internal candidates, some boards even require the CEO to bring in additional talent with greater long-term potential, in order to ensure a smoother CEO transition later.

□ *Strong company performance.* In a "don't rock the boat" way of thinking, some boards believe that it is best not to broach the topic of CEO succession during a company's positive financial times. Yet if there is a lesson to be learned from last year's economic meltdown, it is that companies that were once high-fliers can become tomorrow's takeover candidates. Companies deserve to have in place the best CEO to match current economic conditions at all times.

□ *Inadequate specifications.* Many boards believe their CEO succession planning is contained within a job description filled with overly broad and lofty-sounding attributes. Or worse yet, some directors think that their company's emergency CEO succession plan is a valid substitute for a high-quality long-term plan. These are not the same. Instead, boards should base their CEO succession decision-making on highly specific criteria that define the absolutely critical aspects of the role.

At the board level, if a company lacks a CEO succession plan and directors are forced to quickly select a new CEO, the board is more likely to make an "impulse purchase" it may later regret. The board may fall in love with a particular candidate, to the exclusion of potentially better ones.

The beauty of a disciplined, blueprint-driven succession plan is that it leads to an improved analytical approach to CEO selection. Better still, it can help create a more positive and productive emotional atmosphere in the workplace.

In most companies, few major decisions can be more emotionally laden than selecting the next CEO.

However, with a rigorous, objective succession plan, a board can more readily defuse any potential conflicts or political battles that might otherwise arise internally during a non-strategic selection approach.

When internal CEO candidates know early on that they will be developed and assessed for the role over a lengthy time period (potentially several years), they are more apt to respond positively to the process. This assumes the process is based on specific and unbiased criteria, and informed by data collected from multiple sources.

In contrast, consider a company without a plan that is forced to hire a new CEO within a short span of

time. If there are two or more viable internal candidates, no matter how carefully the evaluation and selection is handled, it is likely that at least one of the candidates will be dissatisfied with the results.

A CEO blueprint process creates the vision and plan a board will use when assessing, developing and selecting a chief executive. It has two distinct stages, both of which are equally needed for succession planning success.

**Stage One: CEO blueprint foundation. Stage one is foundational, incorporating all the base elements that must be in place for the plan to succeed.**

□ *Implement a continuous planning process.* CEO succession planning should be continuous—starting now. Even if you just hired a new CEO, planning should immediately begin for the next successor.

There is a twofold benefit to making succession planning continuous. First, it helps ensure an uninterrupted pipeline of potential CEO candidates. For example, companies like Procter & Gamble and IBM handle succession planning so well they are known as “academy” companies. They have become a source to themselves and others for future CEOs.

Second, having a continuous plan means the topic of succession is never suddenly thrust upon a company. Rather, it is simply “business as usual,” as it should be. Otherwise, if succession planning is brought up abruptly or irregularly, it can send the wrong message to key employees (principally the current CEO) about the board’s confidence in its current leadership.

□ *Create transparent governance guidelines.* To institutionalize continuous succession planning, the board should formally review succession strategy at least twice per year, not only for the CEO’s role, but also for his or her chief lieutenants. Boards should become acquainted with the succession plan for the entire management team to help identify possible CEO successors.

The board’s task of succession planning should be assigned to a committee and members with the

greatest amount of experience in talent management. With most boards, this is typically the governance or compensation committees.

By taking this critical but often overlooked step, the board eliminates the onus placed on any individual director (or company leader) for spearheading succession planning. By purposefully making this effort transparent, a company’s key constituents (including top leaders, investors, analysts and the media) will have greater confidence in the company’s actions.

□ *Have the right board in place.* Involve your entire board in succession planning, and ensure that its members are up to forward-looking decision-making. By definition, CEO succession planning means anticipating and preparing for a company’s future issues and opportunities, not delving too deeply into its legacy.

If your board is comprised of directors who have served long tenures, ensure that they are regularly exposed to the company’s emerging and most original thinking by the company’s experts in these areas. Specifically request that executives other than the CEO make these presentations, to give the board broader exposure to the company’s leaders.

□ *The board owns the process.* Too often, boards delegate responsibility for CEO succession to the current CEO. This is a decision rife with potential problems. For one, in today’s Sarbanes-Oxley era of accountability, there are potential financial and legal consequences to boards that cede away their rightful planning authority. More practically, what if the CEO simply delays or avoids dealing with succession planning?

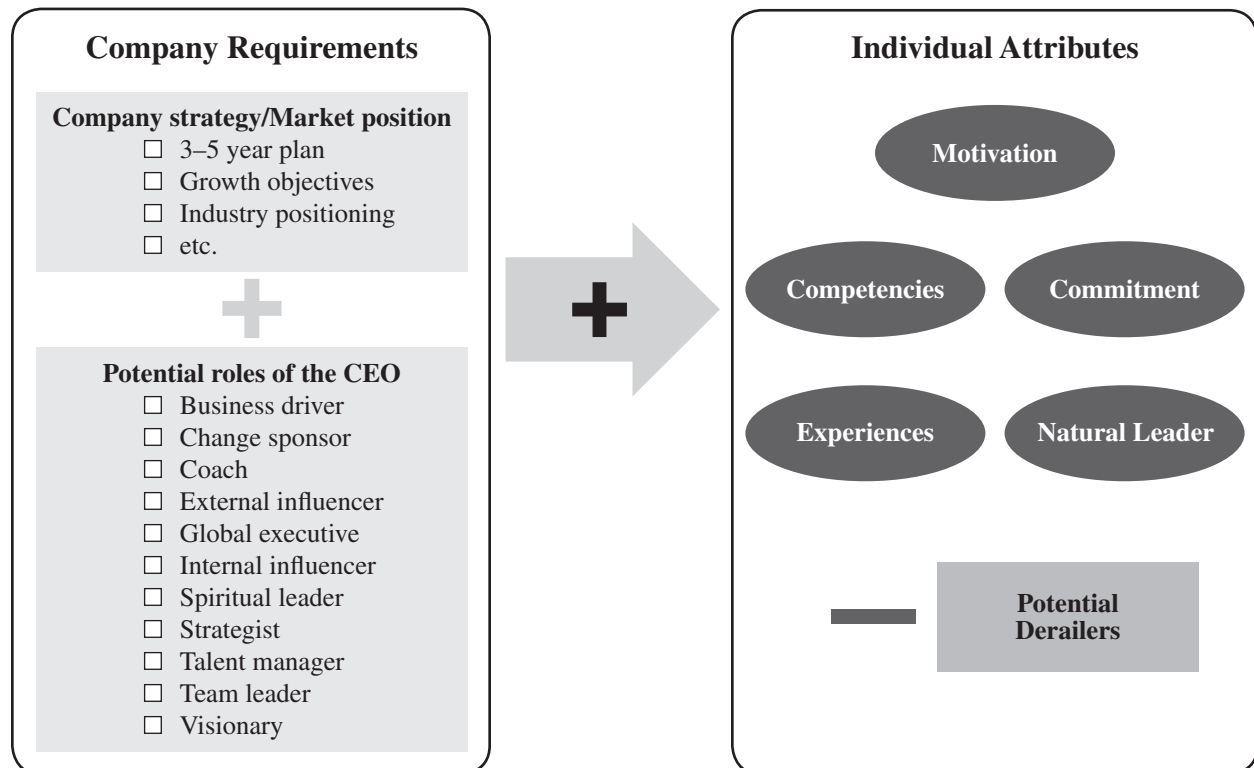
The CEO should serve as a counselor to the board and be accountable for developing talent. Ultimately, though, succession is a board-led responsibility. In fact, the board should make implementation of a succession planning strategy part of the CEO’s annual compensation package.

**Stage 2: CEO Blueprint tactics. Stage two is more tactical, addressing the things boards must do on an ongoing basis for implementation.**

## CEO Blueprint Components

### A Formula For Succession Success

*CEO Blueprint Components* cover two principal areas: Company Requirements (approved by the board) and Individual Attributes. *Company requirements* establish the foundation of the CEO blueprint, and include both strategy-driven components and cultural components. *Individual attributes* are based on the board objectively asking: Does this person truly want this role? What is his or her commitment to the company? Is he or she a natural leader? What experiences and competencies does this person have? And significantly, what are this person’s potential leadership derailers?



*Ongoing CEO engagement.* By making succession planning part of the current CEO’s job description, the board sets the expectation for receiving regular, recurring updates from the CEO (and designates) on the subject. When done well, this step actually enhances the relationship between the board and its CEO.

The board and current CEO should work together to agree upon and create the criteria to be used for selecting the next chief. The final criteria should reflect a candid assessment of both the company’s business strategy *and* its culture. When assessing a potential CEO, many companies make the mistake of focusing on the former to the exclusion of the latter, but both are vital for CEO success.

In our experience, we have identified 11 distinct roles of the high-performance CEO. These include strategy-driven roles like “business performance driver” and “global executive,” as well as culture-oriented roles like “coach” and “spiritual leader.”

The criteria-setting part of succession planning will likely consume the greatest amount of time. Yet once completed, it can also be used as the company’s ongoing leadership development guide, to assess, develop and select leaders for additional rungs on the corporate ladder.

Once the board has hired and installed the successor CEO, it should also have simultaneously established clear and defined guidelines for the exiting chief—to either leave the board immediately,

or serve in a transitional role as chairman for a set period of time.

□ *Ongoing HR involvement.* The company's head of human resources should serve as a facilitator or subject matter expert, to ensure that the board's policies, procedures, needs and deliverables are met. As with the CEO, this expectation of involvement should be tied directly to the HR head's compensation. The board should make its expectations realistic and plan accordingly. Keep in mind that not all HR leaders have familiarity working directly with boards.

□ *Ongoing internal talent monitoring.* Too often, CEOs have their subordinates present their ideas only internally, without exposing these executives directly to the board. When non-CEO executives appear before the board, it is often solely to talk about their functional responsibilities, real-time issues, action plans or metrics. These deliverables may not provide quality insight into their future potential.

Instead, to ensure that the board has the right exposure to top internal high-potential successor candidates, it should require that non-CEO executives regularly appear before the board. "Exposure" does not just mean social conversations over dinner or reports on what the business has accomplished this quarter. Specifically, these executives should be asked to present their views on the challenges, issues and opportunities that the company will face, as well as their high-level thoughts on how it can thrive in a changing marketplace. Boards need exposure to how these executives think.

As part of internal talent monitoring, the board should also ensure that the company is sufficiently developing a pipeline of leaders able to fulfill the board's CEO selection criteria. The board may wish to mandate that the current CEO be part of talent development, which includes objectively assessing and developing internal talent.

To maintain succession planning transparency, the board should be clear and open about its plans and interests. For example, the board could convey that non-CEO board presentations are also part of its CEO succession assessment plan.

□ *Ongoing market assessment.* At least annually, if not semi-annually, the board should review and

assess external market influencers that potentially alter the ideal attributes of the successor CEO. Market dynamics and technology can change very quickly, altering a board's criteria for its future CEO.

Additionally, the current CEO's own work may alter the company's future needs. "At most companies, if a CEO has accomplished what he set out to do, the company's needs will have changed, and the successor will require different skills and experience, as well as a different personality," wrote Kenneth Freeman in *Harvard Business Review*.

Monitoring and reporting on the future impact of external market forces may be an ideal task for non-CEO executives. This provides the board with a built-in opportunity to assess the leadership abilities and preparedness of these executives.

□ *Ongoing external talent monitoring.* Even if a company seemingly has a robust amount of internal talent, it is still wise to keep track of viable external candidates at the same time, using the resources of an executive recruitment firm. Many companies use such firms only on a transactional basis, when they need to fill a particular role. However, as part of its ongoing relationship with your company, a recruitment firm should be willing (without charge) to identify and monitor select external candidates who match the board's stated CEO criteria.

When deciding upon an executive recruitment firm, ask specifically if the firm has access to the widest possible selection of potential candidates. Ironically, the largest recruitment firms are often unable to supply the greatest number of high-quality candidates due to their pre-existing contract relationships with other companies.

The impetus for a board adopting more formal CEO succession planning often begins at the recommendation of just one or two board members seeking a better way of CEO selection. Perhaps these are directors who have previously been part of an inefficient, reactive CEO selection process, struggling to find quality candidates, and vowing to themselves "never again." Whatever the reason, your board should adopt its own CEO succession planning process. Now is the time to begin. It is a board decision you will not regret. ■