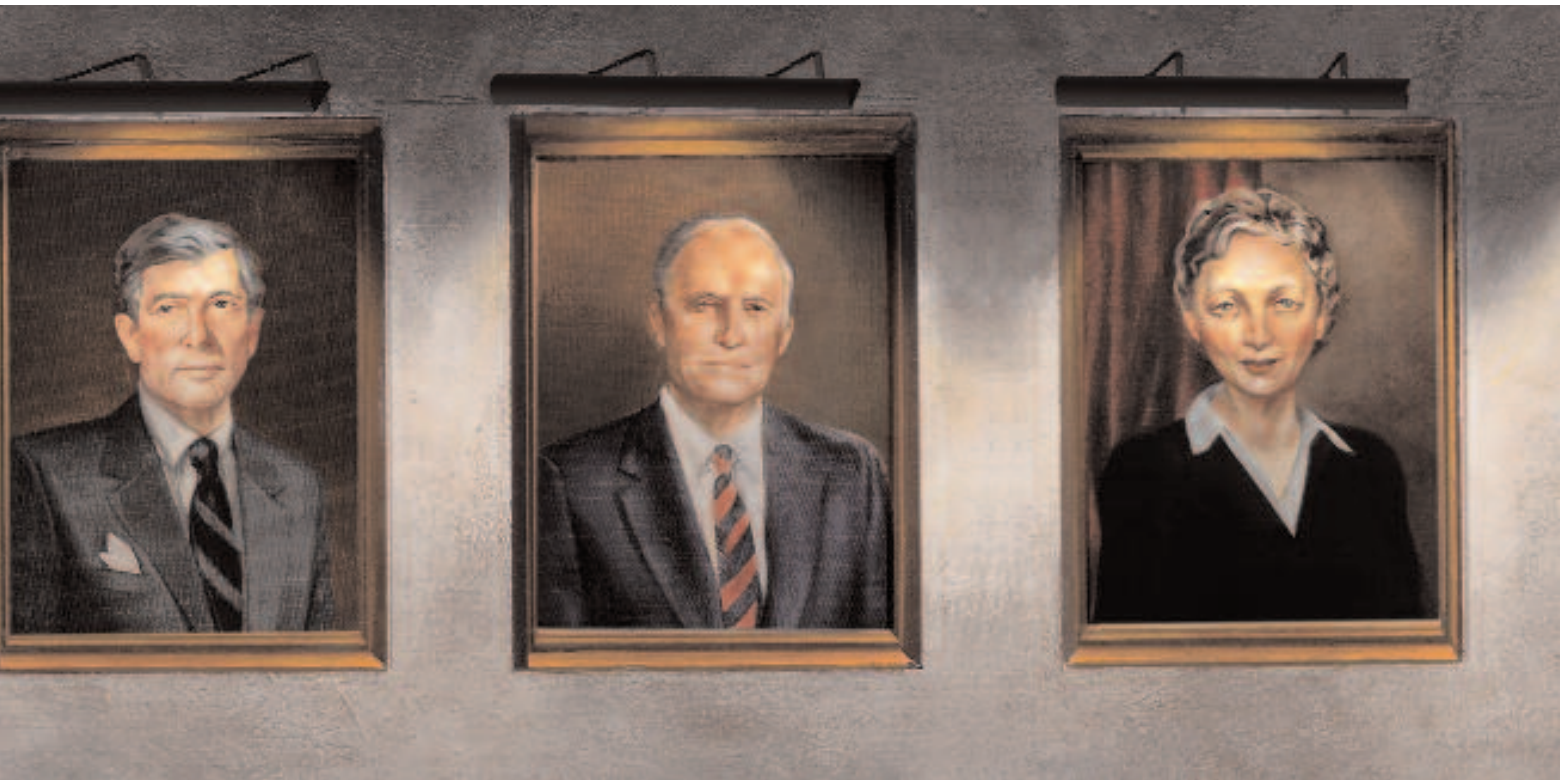


# Your Next CEO

Why succession planning  
is more important than ever.

By Matthew J. Paese



I've never heard a board predict that its newly appointed CEO will fail. Without exception, boards hold aloft their fresh-faced savior before hopeful shareholders, proclaiming him or her the perfect leader to take the company to the Promised Land. I'm still waiting for the true realist to emerge from the boardroom and announce, "We're making this CEO-succession decision recognizing that it probably won't work out, and that next year at this time, we'll be looking for a replacement."

Of course, it's absurd to imagine any board openly condemning an incoming CEO, but if board members were appointed purely to make accurate predictions, that's precisely what many of them would be compelled to do. The data supports it: Over the last decade, CEO turnover

agility, and so singularly central to business success that the task of picking a successor has become the holy grail of talent management, befuddling even the most enlightened boards.

In 2006, when a CEO left, there was nearly a one-in-three chance that he or she was forced out for poor performance—up from a one-in-eight chance in 1995. But if the rules of corporate governance weren't already complex enough, new guidelines have intensified the scrutiny that boards and shareholders place on the CEO succession process. If one compares CEO succession to stock investments, the customer now wants to be part of the broker's research and jointly ensure that the final investment is the best option.

Meanwhile, amid these heightened demands and complexities, the processes that boards use to drive CEO succession have changed little. By and large, boards remain attached to badly outmoded methods of identifying and choosing the next chief executive.

Much has changed to make the landscape of CEO succession more complex and difficult, and the traditional methods used by boards and senior-management teams are insufficient to meet the challenge. This article proposes a new set of rules, reframing CEO succession to establish a pipeline of leaders developing toward the senior post, dramatically reducing the error in CEO succession decisions, and building greater leadership stability at the top.

## The Increasingly Dynamic CEO Job

When it comes to the CEO role, change and chaos reign supreme. The daily news and CEO turnover data show that as the leadership terrain becomes more jagged, we can expect more sudden and frequent mismatches between CEO capabilities and the demands of the job. A few reasons are paramount.

**Changing markets.** Terry Semel, Yahoo!'s onetime CEO and recently departed chairman, is a case in point. Joining the company in 2001, shortly after the bursting of the technology stock bubble, he seemed the perfect man to lead Yahoo! through the storm. Focusing the organization on its media and advertising lines of



has increased by over 50 percent, and performance-related departures by over 300 percent.

Whether due to declining CEO capability, increasingly daunting CEO roles, impatient boards, or all of these, the shelf life of the average CEO has shortened. The contemporary CEO assignment is so dynamic, so riddled with unforeseen landmines, so demanding of leadership

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business, Semel led Yahoo! to prosperity—at first. Archrival Google soon assumed a dominant market position in both Web search and online advertising.

In a jarringly short period of time, the CEO assignment at Yahoo! morphed from driving execution in an existing business into penetrating new markets and establishing new businesses—two very different assignments requiring very different skill sets. After struggling for some time to meet these new challenges, the board elected to replace Semel in the summer of 2007 (far too late, as some have asserted), and recently, he stepped down from the chairman seat.

**Globalization.** While changing market conditions have caused many otherwise-successful CEOs to fall from grace, other developments have also accelerated the rate at which organizational focus changes. Globalization has dramatically heightened the intensity of competition, and has abruptly shifted the focus of many organizations such as Nissan, led by Carlos Ghosn, who at the turn of the century presided over the merger of French Renault with Japanese Nissan.

The union presented Ghosn with one of the great culture clashes in automotive history as well as the need to revive an ailing company, while solidifying a unified global management structure. (Think: Japanese + French, and the magnitude of the task becomes clear.) This challenge, which Ghosn quickly conquered, was soon succeeded by the arguably more business-critical target of dominating the burgeoning Asian market—a goal at which Nissan and its Asian automotive competitors continue to aim. As Ghosn illustrates, globalization has reshaped and will continue to reshape the challenges for CEOs.

**Rapid action for underperformance.** The practice of removing underperforming CEOs, or even those with an anticipated struggle ahead, is a reality in today's competitive and demanding climate. Private-equity firms typically remove incumbent CEOs almost immediately after acquisition, with the express intent of selecting a new CEO with precisely the right skill set to turn the organization around.

"The success of our acquisitions can be very reliably predicted by the strength of the CEO and leadership team," remarks a senior investor at a global private-equity firm. "The problem is that we make the wrong assessment too often." Boards all too frequently make similar decisions, as in cases such as Home Depot, The Gap, Dell, Pfizer, and numerous others who removed CEOs for underperformance.

**Heightened scrutiny.** Meanwhile, as the CEO role has become more dynamic and complex, scrutiny and performance expectations have risen dramatically. Corporate meltdowns at Enron, WorldCom, Tyco, and elsewhere have spurred both legal and social scrutiny on corporate leadership, leaving a climate of doubt and suspicion around many corporate practices, and an elevated expectation of CEO accountability for ensuring propriety. Consider Mark Hurd and the Hewlett-Packard board scandal as a case in point.

Taking these developments together, while the job of

CEO is becoming more difficult, the expectations for performance and transparency are rising.

## The Increasingly Stagnant Board of Directors

One of the principal roles of a board of directors (or senior team in a private company) is to ensure that policies and practices are in place to govern CEO succession. Indeed, the NYSE Listed Company Manual cites CEO succession planning as one of seven primary tasks of the board of directors. But the complexity of the CEO role has left corporate boards without an appropriate response to CEO succession. Absent strong alternatives, many default to their traditional methods of identifying and selecting CEOs, and it's ever more clear that, in the current environment, these methods are highly flawed and must be revised if companies are to achieve greater leadership continuity. They include:

**Instinct over objectivity.** In keeping with their responsibilities, boards routinely request one or more successors to be named as eventual contenders for the CEO role. However, it should come as no surprise that when the actual moment of succession arrives, many of these named successors are deemed a poor fit for the job. In a 2007 *Directorship* article, former Medtronic CEO Bill George described what typically occurs when no internal candidates are available: "Next, the board calls in the search firms, which dutifully flip through their Rolodexes and contact the usual suspects. They give the board a list of well-known 'big names,' whose résumés impress the directors. The board invites one or more of them to meet its members in a series of well-orchestrated interviews, followed by a dinner at which the candidate displays power, outward self-confidence, charisma, and charm. After some superficial reference checks (often carried out by the far-from-disinterested search firm), the board selects its new CEO."

The looseness of this process is endemic to the search for external CEOs—and, often, characteristic of internal promotions as well. Coca-Cola's 1997 promotion of Doug Ivester from second-in-command illustrates how the process can lack due diligence when making internal CEO succession decisions as well.

Ivester's short and checkered tenure as Coke's chief was characterized by arrogance, insecurity, poor political savvy, and unwillingness to listen to and involve key constituents. Looking back at how these factors contributed to the series of debacles that caused Ivester to fail in just over two years, it's clear that the risks of his leadership tendencies should have been identified in advance—and clearly weren't.

But the typical CEO assessment process is not inclined toward depth and diligence. "Too comprehensive" was the judgment of one board member at a major medical-products corporation when presented with a more in-depth process for assessing CEO candidates. "This process is clearly more

rigorous, but it's not right for us," he concluded.

As puzzling as his assessment may seem, he is not alone. Many boards simply prefer to trust their instincts. Some view more comprehensive methods involving deeper assessment and more structured decision processes as too burdensome and limiting; directors fear that the process will constrain their freedom of judgment or turn off would-be candidates whom they believe would prefer not to be assessed. As a result, organizations often employ more structured processes for selecting frontline supervisors than for identifying their next CEO.

**Experience over competence.** Most board members have considerable industry experience as well as their own track records of success, but all of this experience tends to result in an assessment process that gauges just one thing: experience. Predicting senior-leadership success requires looking at far more than experience.

The assessment should also examine knowledge, competencies, skills, and personal attributes to understand what the candidates have done in the past, what they're capable of accomplishing in the future, and the character traits that will impact their performance.

But most boards are focusing primarily on experience. Comparisons of track records, prior accomplishments, employers, and industry savvy are the main areas of inquiry. The candidate with the experience that matches best tends to be considered the most qualified.

Still, rendering judgment after assessing only experience leaves critical profile elements unaddressed. The assessment of competencies such as enterprise-level strategic planning, influence, complex relationship management, political navigation, and courage requires deeper and more focused inquiry. Certainly, interviews can help measure competencies, but interviews that focus on experience—as most do—will typically yield little useful competency information. To get more reliable competency information, some organizations are now turning to CEO simulations in which observers can judge many of these skill sets in real time.

**Knowledge over personal attributes.** Perhaps the most neglected area in companies' CEO assessment is the measurement of candidates' *personal attributes*. These are stable, unchanging characteristics of human beings such as personality and cognitive ability, which interviews cannot measure accurately but which play a pivotal role in senior

leaders' success and failure.

Critical factors such as emotional adjustment, intellectual curiosity, ambition, and learning orientation show us the positive and productive aspects of a leader's profile. Arrogance, perfectionism, volatility, imperceptiveness, and others show us the aspects of one's profile that often derail leadership success. All leaders carry elements of both aspects, and research has shown differences to be predictive of behavior patterns.

As important as these personal attributes are in predicting leadership success and failure, boards seldom factor them into CEO succession decisions. Looking back at the notorious Ivester decision, we can assume with little doubt that he possessed tremendous knowledge of the Coca-Cola organization, along with a strong track record of success. His competencies almost certainly included disciplined execution and sound fiscal management—though closer examination of his involvement skills and political navigation was clearly called for.

With respect to personal attributes, it seems likely that Ivester would have scored high on factors related to intellect, planning, and arrogance and low on variables such as interpersonal sensitivity and fear of failure. The question is whether the board appropriately factored these latter variables into the final analysis of his fit with the Coca-Cola job.

**Politics over precision.** With such a weakly structured process, it should come as no surprise that reaching agreement is often difficult in CEO succession. A Fortune 500 consumer-products corporation recently hosted an interview process identical to the one Bill George describes. Following a day of unstructured interviews and the customary dinner, the interviewers huddled the following morning to integrate their observations. After much wrangling and debate, the six-person interview team found itself with six completely different opinions about the candidate's fit with the chief post. Evaluations ranged from "perfect fit" to "maybe after some more experience" to "not a chance."

Several key barriers stand between boards and accurate assessments of CEO candidate capabilities. First, the politics of CEO succession decisions are complex and intense, leaving many boards with a profound sense of accomplishment for simply having reached agreement on any succession process. While boards are ostensibly assembled to present balanced and unbiased input, political factions inevitably complicate matters.



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For example, a multibillion-dollar research organization recently embarked on the search for a new CEO. When asked what the new officeholder would be required to deliver to the organization, the incumbent CEO described a profound rift within the board. One camp was strongly oriented toward the appointment of a CEO with academic credentials and a track record of research experience and scientific accomplishments. The other camp held firmly to the belief that academic credentials were secondary to the business know-how that would be needed to preserve the organization's fiscal health and efficiency.

One group sought a scientist, the other a businessperson. Clearly, a group divided in this manner would have difficulty agreeing on how to structure the assessment process; without reconciliation, accurate assessment of candidate capabilities seems almost impossible.

A second barrier to accurate analysis is the belief that CEO applicants will bristle at the prospect of objective assessment that goes beyond interviews—for instance, leadership simulations that require candidates to think and lead their way out of realistic CEO challenges; or self-report inventories that look more deeply into personality and work values. Some feel these exercises constitute a screening process rather than a recruitment process and deem them inappropriate for CEO-level decision-making.

But when CEOs such as Home Depot's Robert Nardelli or Pfizer's Hank McKinnell fail to perform and then walk away with hundreds of millions in severance pay, this seems like a small investment.

To further the point, it is untrue that candidates are resistant to deeper assessment. In one of the best-executed mergers in the medical-diagnostics industry (or any industry, for that matter), Quest Diagnostics CEO Ken Freeman conducted comprehensive assessments of approximately 175 executives (spanning both organizations) to determine who would lead the newly merged organization. Although the executives felt as though they were re-applying for their own jobs, Freeman made it clear that the health of the business relied on appropriate leadership placement decisions, and that he would resist relying on his gut to make these critical decisions. Freeman actually went through the process as well, to learn about his own strengths and weaknesses to enable himself to be an ambassador for the process.

Some found the process to be pressure-packed, but the

vast majority reported positive feelings and felt more confident about the merger. This is consistent with research showing that more rigor in the selection process enhances candidate impressions of the hiring organization.

**Replacement over development.** Some see an additional barrier—CEOs' reluctance to develop leaders to replace themselves—and blame self-preservation and ego. Rarely is this actually the case: Ego, and the related desire to leave a strong legacy, are precisely what drive many CEOs to champion the succession process themselves.

Organizations around the world are struggling to grow talent, a trend that directly relates to CEO development. In a recent survey of 412 (non-HR) executives representing the United States, Europe, Asia, and Australia, DDI and the Economist Intelligence Unit found that 55 percent expect their business performance to suffer in the near future due to a lack of leadership talent. Eighty percent reported that their management teams agree that talent management is a central business priority, equal to or more important than other business priorities. Yet only 27 percent believe that they are doing a good job of managing talent, and only 40 percent are satisfied with the rate at which internal talent is growing.

Clearly, the recognition that talent must grow is distinct from the ability to make it happen. CEO development is no exception. But years ago, before delayering and downsizing, organizations had many more high-potential leaders in the on-deck circle. Developing the next

successor to a key position was as simple as identifying a candidate and ensuring that he or she followed the requisite management path to prepare for a higher-level destination.

Rotation programs such as this have become obsolete—the gaps between leadership levels have widened dramatically, and the target roles for rotation have been eliminated. The result: a massive push to find ways to accelerate the growth of leaders through aggressive assignments and experiences that pull leaders forward in their development. The problem is that finding ways to dramatically accelerate leaders' growth is a complex task and not one in which most board members have experience.

Another barrier to accelerated development of CEO candidates is fear of the internal "horse race," which Jack Welch made famous by publicly announcing his top

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three front-runners for the top job at GE. These races do more harm than good in most organizations; companies can accelerate development without creating an overt race for the CEO job.

A case in point is the Doe Run Corp., a midwestern mining and recycling organization, which prepared for its CEO's impending retirement by launching an aggressive development process. CEO Jeff Zelms created a five-person "Office of the President," including himself and his four top leaders, to mutually address some of the most pressing challenges at the top.

The team began tackling CEO duties together, to spread key experiences among the players. The goal was to build more general leadership capabilities among the senior team, irrespective of which of the four would be named the next CEO. Zelms was quick to assure his staff that no succession decisions had been made, and that external selection was always an option. While each team member likely held private hopes of being selected, ultimately, the broader exercise overshadowed personal desires.

After about eighteen months, one key senior leader, Bruce Neal, began to show signs of readiness for the CEO role. An external search was called off, and the company installed Neal as CEO in a virtually hitch-less transition. Now, after two years in his role, Neal is presiding over record profits and global expansion, while enjoying tremendous bench strength. Both the company and his senior-level partners benefited from the development that Zelms had initiated.

This creative and aggressive approach to development highlights the fact that CEO succession can no longer be the episodic replacement planning process that once proved sufficient. The routine search for internal leaders with high potential, and the constant cultivation of their growth toward the CEO role, are central to building leadership continuity.

## Succession Success

**Start soon and never stop.** How soon? *Now.* Over and over, we see organizations caught unprepared by unexpected crises or opportunities and forced to suddenly look outside for the next CEO. This not only ensures a likely drop in stock value—it introduces significantly greater business risk, since externally sourced CEOs are more likely to fail.

Some have suggested that CEO succession should begin at least three years prior to the anticipated change. This recommendation, or any that prescribes a specified time frame in which to administer the succession process, misses the point. CEO succession must begin immediately and must be a constant, ongoing process that is managed as closely and regularly as the organization's most pressing business affairs.

**Look more closely at candidates.** In the same way that emerging CEO demands are difficult to predict, so too are

the human beings that occupy those roles. However, the prevailing method for assessing CEOs—to extensively interview candidates—dramatically oversimplifies both the job and the individuals who might fill it. To achieve a more accurate assessment of CEO capability, boards must better define requirements and more deeply assess the capabilities of the incoming CEO.

This means breaking the tradition of private interviews with board members, long many companies' most important—or even the only—assessment method. Interviews are unquestionably a central component to this process, but the typical unstructured interview is riddled with inherent error and must be enhanced by additional assessment measures, particularly leadership simulations, to more closely examine central attributes that might not otherwise be detected.

**Make the growth of top leaders a board imperative.** If we are realistic, we must recognize that scenarios will sometimes arise in which no viable internal candidate is available. However, this should not deter organizations from constantly cultivating and growing top leaders' capabilities. Hesitations rooted in the fear of a horse race, political dynamics, or the job security of the incumbent CEO must be dispatched in favor of more enterprise-conscious strategies. Boards must assume that the CEO role is always unstable, and that the organization's top leaders must be developed to the very peak of their potential to sustain maximum agility.

This requires that the company identify a pool of internal leaders as potential CEO candidates and develop them toward that standard. Top management should conduct early assessments and prepare individualized development strategies to be discussed with the board. Since development must support the organization, each development plan should be reviewed for its impact on business progress as well as on individual growth. Measures of success in both arenas should be tracked and reported to the board regularly.

**Use CEO succession as a model for talent strategy.** CEO succession is not a decision—it is an ongoing process to diligently foster and drive the growth of internal leadership capability. To adequately address the challenge, boards must begin by developing a strategy for CEO succession that encompasses the identification and recruitment of high-potential leaders from inside and outside the organization, the profiling of the CEO role and its core challenges, the assessment of candidates' leadership capabilities, and the accelerated growth of a pool of leaders toward the CEO target.

While CEO succession is aimed at a single position, the principles apply to talent growth across the entire organization. If done poorly, the organization fights an uphill battle to build sanction, support, and involvement in processes that drive talent growth. If done well, CEO succession not only ensures stability at the top post—it can serve as a model of how talent should be cultivated and deployed for the long-term benefit of the enterprise. 🌱