

A photograph of two men in business attire shaking hands. The man on the left is younger, with a beard, wearing a light blue shirt and dark tie. The man on the right is older, wearing a dark suit and tie. They are both smiling. In the background, other people are blurred. The image has a blue overlay.

**NOMINATING/GOVERNANCE  
COMMITTEE:**

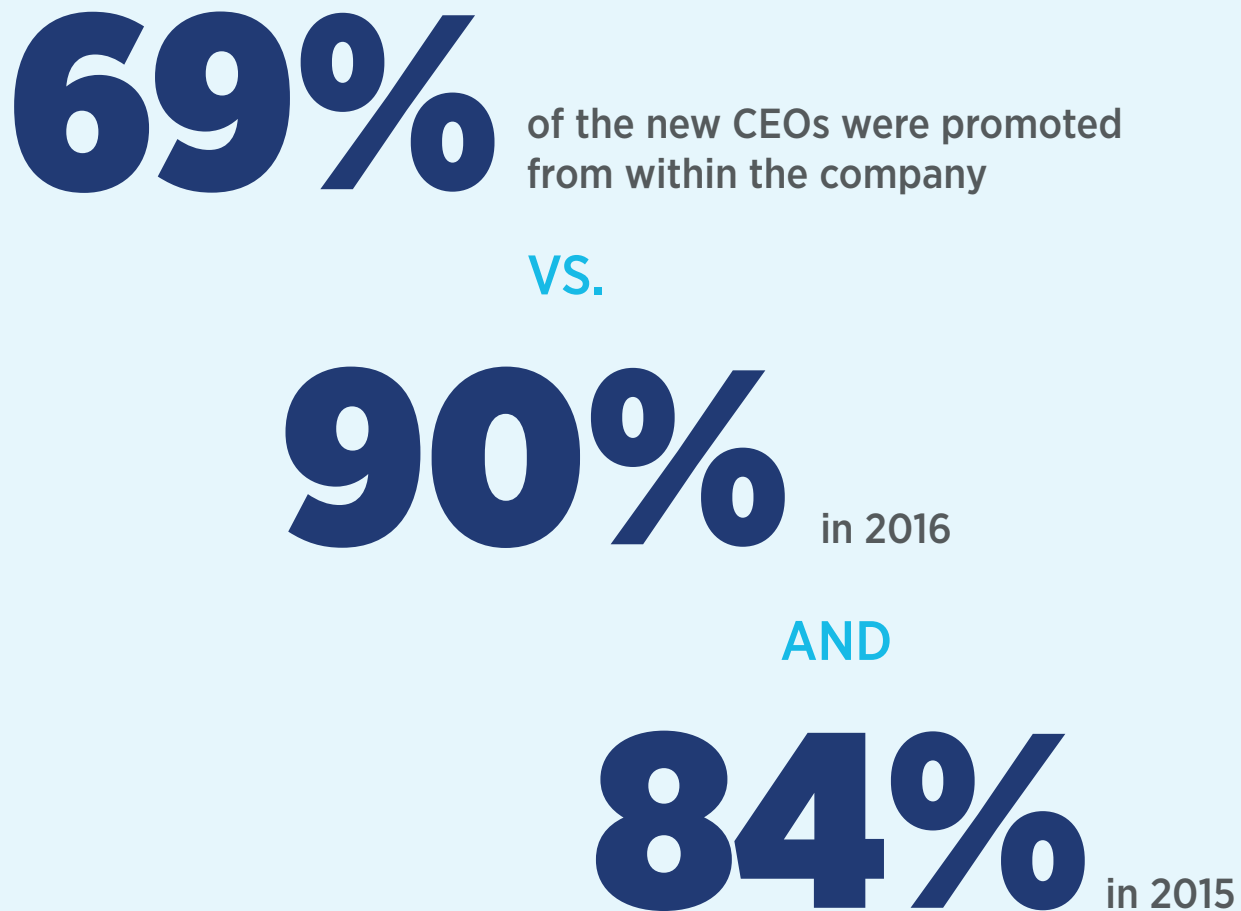
**SUCCESSION  
PLANNING**

# CEO Succession

The nominating/governance committee generally has responsibility for board succession planning, and it may also lead the board's work overseeing CEO succession planning. Both roles, arguably the most important responsibilities of the board, are of vital importance to a company's success. Effective succession planning enables boards to make the best decision for the company in the event of planned or unplanned transitions.

## CEO SUCCESSION PLANNING

Getting succession planning right is not a hypothetical consideration for most companies. Fifty-nine S&P 500 companies installed a new chief executive in 2017, the highest number of transitions in the last 10 years. Since 2007, when 58 companies named new CEOs, the number of transitions generally declined before hitting a low of 37 in 2012.



Source: Spencer Stuart CEO Transitions 2017

The stakes are high when it comes to CEO succession planning. The impact of the CEO—especially one who fails—is staggering:

- The economic cost of appointing the wrong CEO at global companies is estimated at more than \$100 billion.<sup>1</sup>
- Nearly one-third of investment decisions are related to the reputation of the CEO; 39 percent of investors say they would likely sell a stock based solely on the CEO, while only 15 percent say they are likely to buy a stock based on the CEO's current reputation alone.<sup>2</sup>
- A study conducted by Rakesh Khurana, dean of Harvard College, and Nitin Nohria, dean of Harvard Business School, found that CEOs appointed after 1985 were three times more likely to be fired than CEOs who were appointed before that year.
- According to Harvard Business School, 40 percent of all executives who change jobs or get promoted fail in the first 18 months, a number that has remained steady for the past 15 years.

When it goes well, CEO succession planning produces a strong successor who, in the short term, is well-received by the organization and its stakeholders, including Wall Street, and, in the long run, has the right vision and strategy for the business and drives the company to achieve growth and create value.

Nominating/governance committees should strive to oversee a best-in-class process that maximizes the future readiness of internal talent, coalesces the board directors around a forward-looking CEO profile, aligns directors behind the ultimate selection and identifies the best candidate for the CEO role. However, CEO succession planning can be fraught with hidden risks and challenging dynamics that, if not recognized and managed, can derail the process and destroy value.

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Source: "2014 study of CEOs, Governance, and Success," Strategy&, April 2015, <http://www.strategyand.pwc.com/global/home/what-we-think-reports-white-papers-article-display/2014-ceo-study>

Source: "CEO Transition Study," FTI Consulting, October 2011, <http://www.prnewswire.com/news-releases/fti-consulting-study-shows-ceo-transitions-are-a-risky-business-when-it-comes-to-shareholder-value-132044798.html>

# CEO Succession: Best Practices

In our experience, nominating/governance committees can best position boards for successful CEO succession planning by ensuring the committee and the board follow these best practices:

1

## ADDRESS SUCCESSION PLANNING EARLY AND WITH REGULARITY

Though the board has the ultimate responsibility for CEO succession planning and selecting a CEO successor, it can be difficult to initiate discussions about succession, particularly with a high-performing CEO who doesn't plan on leaving any time soon.

However, by developing a regular cadence around C-Suite succession planning, some of the sensitivities that surround this type of planning can be avoided.

One of the best approaches is to begin CEO succession planning when a new CEO takes the helm and immediately set expectations about the CEO's role in the process. Starting early and making succession planning an ongoing activity can help minimize the emotion that often surrounds succession and enable the board to get to know potential candidates and their performance over time.

Some of the tension surrounding the issue can be eased if the initial conversation with the CEO focuses on the emergency/contingency plan—the “name in the envelope” in case of an unexpected health or family emergency. From there, it can be easier to extend the discussion to the CEO's timeline, making it clear the expectation that the CEO will inform the board of his or her plans two or three years in advance to allow for an orderly succession plan.

2

## ENSURE THE STRATEGY AND CRITERIA FOR THE NEXT CEO IS FORWARD-LOOKING

The foundation for CEO succession planning is an agreed-upon strategic direction for the company from which the criteria for the next CEO can be based. The best processes look ahead to where the company needs to be in five to 10 years and avoid articulating strategies too rooted in the present or overly reliant on status quo assumptions. A failure to think about the future may result in criteria for the next CEO that are disconnected from the specific strategic, organizational and operational levers that the next CEO will need to employ and potentially impede the development of internal candidates with these capabilities.

Agreeing on a future-looking strategy that informs the criteria for the next CEO is a critical step that helps make the process go smoothly. It also helps boards avoid the trap of choosing an executive who mimics the incumbent's strengths, instead of selecting the candidate with the qualifications best suited to the company's strategy for the future.

3

### INCLUDE THE CEO AS AN ACTIVE PARTICIPANT IN THE SUCCESSION PLANNING PROCESS

Ideally, the CEO will, early in his or her tenure, emphasize a commitment to management development and provide internal succession options for the board to consider on a long-term basis. The CEO should be a proactive, engaged partner with the board in a regular C-Suite and CEO succession planning process, including planning for emergency succession scenarios.

And as a transition grows nearer and the attention of the organization begins to turn to the next CEO, the board should support the CEO in managing his/her emotions regarding the changes and in stepping back as the process progresses toward the selection of the next CEO.

4

### ASSURE THE DEVELOPMENT OF A ROBUST SUCCESSION PIPELINE

CEO succession planning requires an internal process for developing talent for the top positions in the company, and compensation plans linking CEO and other top executive pay to their success in developing and retaining talent. By taking these actions, boards can more effectively prepare their companies for succession over the short term and help build the bench strength that the company needs for stability and success well into the future.

For the committee responsible for overseeing CEO succession and boards, having confidence in the succession pipeline means ensuring that the CEO is focused on developing a succession-ready team and that directors have the insights about potential CEO contenders in order to oversee the necessary developmental assignments and, ultimately, to choose a successor. This ideally is a broad-based effort that incorporates up-to-date position descriptions for the senior team, regular assessments and benchmarking, and thoughtful developmental assignments.

At least annually, boards should also plan on a deep-dive talent review, which includes having the CEO and CHRO lead a discussion about forward-looking leadership requirements against which talent can be evaluated. By being involved on an ongoing basis, the board can observe patterns of performance and develop a more nuanced point of view on executives' strengths and weaknesses.

## QUESTIONS YOU SHOULD ASK: CEO SUCCESSION PLANNING

1

Does the board have a CEO succession plan?

2

How often is the plan reviewed and analyzed?

3

What is the CEO's role in the succession planning process?

4

Does the succession plan include emergency succession needs?

5

What executive leadership transitions are anticipated?

6

Should board composition be adjusted to complement the capabilities of the next generation of leadership?

# CEO Succession: Best Practices

5

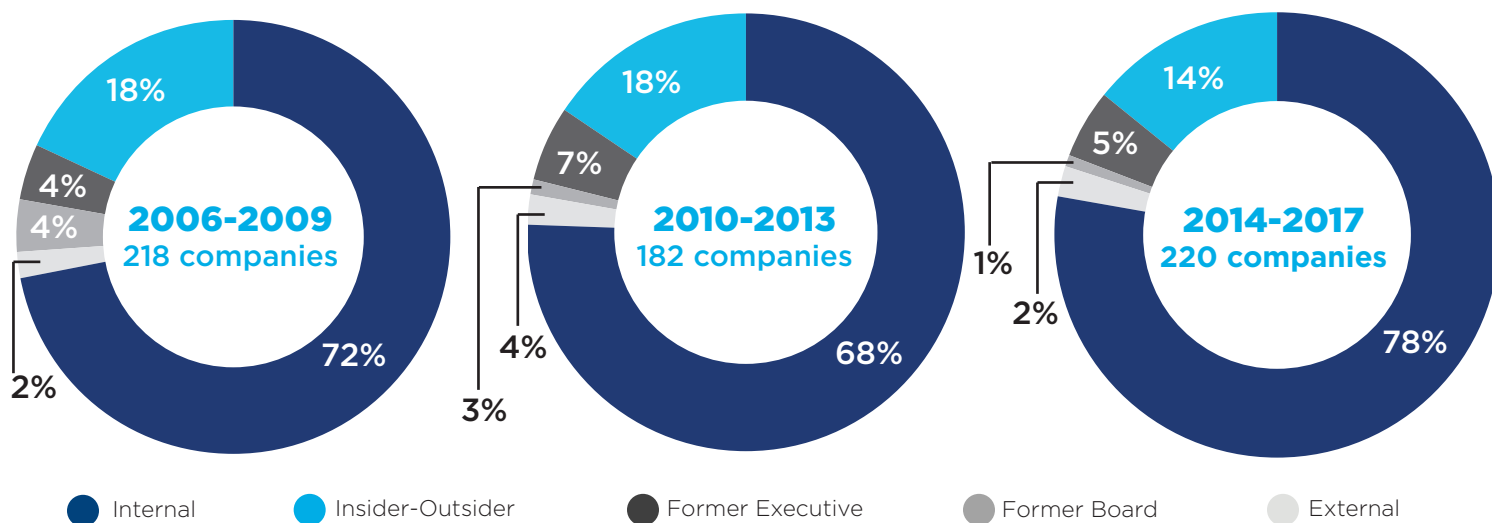
## THOUGHTFULLY AND EFFECTIVELY ASSESS INTERNAL CANDIDATES

Boards tend to see internal candidates through a very narrow window of observation and judge potential based on past performance, which can cause bias (positive and negative) when considering successors. To gain insights needed to understand the capabilities of the company's rising executives and make discerning judgments about their readiness for the top role, the committee responsible for CEO succession planning should ensure that boards get to know the senior leadership through presentations in the boardroom and regular meetings outside of it.

In addition, boards should be willing to cast the net wide enough to consider executives who have greater potential over the long term but require more development time. A longer process provides the time to uncover and develop these "unexpected" candidates, allowing the board to get to know them and become more comfortable with promoting the next-generation leader into the CEO role.

When it comes to internal candidates, boards should embrace an assessment process that is fact-based, rigorous and forward-looking. Objective, third-party assessments can be valuable, particularly if done early enough to provide candidates time to develop and the board time to build a fuller, more nuanced view of internal players. Potential successors are much more likely to be ready if development plans are set early and are based on a clear understanding of individuals' strengths and gaps, and the board has a chance to observe progress against goals. The board should review the plans and candidates' progress at least annually, recognizing that a minimum of one year is required to make meaningful and sustained progress in key developmental areas, and even more time is needed to close gaps in experience.

### NEW CEO BACKGROUNDS



Source: Spencer Stuart CEO Transitions 2017



**144** were promoted from within the company over four years

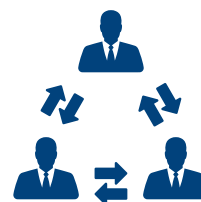


**91%** were first-time CEOs

## INTERNAL CEO SUCCESSORS



**24%** were promoted from division CEO



**6%** were promoted from the chief financial officer role



**42%** served on a public company board before becoming CEO



**47%** were promoted from the chief operating officer role

Source: Spencer Stuart study of internal CEO successors in S&P 500 companies from 2012 through 2015.



## ENGAGE WITH INTERNAL CANDIDATES

Losing a strong internal succession candidate is a greater risk than many boards appreciate. Boards should assume that the strongest internal candidates frequently receive calls about opportunities at other companies. Generally, when internal candidates trust the succession process and timeline, they don't take recruiter calls. However, that can change abruptly. There can be many reasons why a leading internal candidate might begin to mistrust the process, such as a comment (often off-hand) from the CEO suggesting a change in the timeline.

Boards should ensure that potential insider candidates have clarity about the succession process and general timeline and certainty about their value to the organization. One of the most important things the board should do is to establish an open line of communication with potential successors. This begins by creating opportunities for executives to interact with the board directly, with the purpose of ensuring that the board gets to know key leaders and that the leaders get to know the directors. The CEO should encourage these interactions by suggesting recurring check-ins, which should occur more often as a CEO transition approaches, in conjunction with each board meeting, for example.

Because some CEOs can be sensitive to the board wanting to meet directly with potential successors, which can make them feel like a lame duck, it is safest and most natural to focus the conversations on the business or function the executive is leading today, and their individual development plans. For example, it can be effective to have a director spend a day with an executive reviewing the business or addressing the team, which provides a platform for a more natural interaction outside of the formal board meeting environment. This is an opportunity for the board to let an executive know how much the board values him or her.

Board engagement with internal candidates can provide an additional benefit as the succession process nears its conclusion: When the board has been actively engaged with internal candidates and garnered their trust during the process, it will be in a stronger position to approach the runners-up after the selection about their future plans. Every CEO transition carries the risk that executives who are critical to the success of the business will leave the company, especially if they vied unsuccessfully for the CEO role. When the lines of communication have been open, directors can have authentic conversations with runners up about their value to the company, increasing the chance that they may be willing to stay.



# CEO Succession: Best Practices

## QUESTIONS YOU SHOULD ASK: TALENT PIPELINE

1

Does the company have a robust pipeline of executive talent?

2

Does the board have a regular process for evaluating executive talent?

3

Does the board have sufficient opportunities to engage with executive talent?

4

How does the board engage with executive talent?

5

Does the board understand the strengths, weaknesses and development plans for executives and rising talent?

6

Does an independent third party provide assistance with executive evaluations?

7

Has external benchmarking been used recently to assess the company's executive talent strengths and gaps?

7

## INCORPORATE EXTERNAL BENCHMARKING

Companies that are strong producers of internal talent sometimes lose a sense of how their talent compares to the best-in-class talent externally or overlook how the world has shifted around them. Taking a look at external talent—through research, informal or formal introductions or with the support of an executive search firm—can provide additional insight when assessing the readiness of potential successors, evaluating the relative strength of the internal candidates and identifying any experience gaps.

Ideally, external benchmarking should happen in tandem with internal assessments, so that the results of internal assessments and external benchmarking can be compared simultaneously. This process is critical to giving the board a good sense of the relative strength of the internal candidates, as measured against outside talent who have proven themselves as skilled in the operational areas that will be critical for the company's future success and have demonstrated values and behaviors that align with the ideal company culture. The comparison also offers insights into how development plans may need to be shaped or refined to accelerate the readiness of internal candidates so they compare well to best-in-class external options.



# 8

## PLAN FOR THE TRANSITION

As a transition nears, the board and CEO should define a more concrete time line for succession. The CEO should be encouraged to shift his or her mindset from “what am I leaving?” to “what am I building?” and think in terms of the legacy left by preparing the next CEO and handing over the reins at the right time, and this includes making room for the development of succession candidates.

Boards should avoid “winging” a transition and instead play a purposeful role in the immediate transition. Beyond the “necessary” activities, such as communicating with stakeholders, negotiating compensation for the new CEO and meeting SEC reporting requirements, boards should be engaged in a rigorous transition process to help advise the outgoing CEO, plan retention strategies for non-selected candidates and other key management players, and coach the incoming CEO through the initial transition period.

The arrival of the new CEO does not mark the end of the CEO succession process. The board may be tempted to move on, but a new phase of the process is just starting. The integration phase is complex and requires active board involvement well beyond the classic first 100 days. The board should stay involved in the CEO transition to ensure the incoming CEO establishes a clear plan for the early days of the transition and that it is executed in a disciplined manner. The board also should make sure that the outgoing CEO provides the necessary support to the new CEO without seeming to interfere.

# Board Succession

Today, in addition to acknowledging the vital importance of long-term CEO succession planning, boards are increasingly embracing the need for board succession planning. Nominating/governance committees are responsible for leading the way and thinking strategically about boardroom composition and director performance.

Boardroom succession planning is becoming a strategic imperative. With the rapid pace of change in business today, companies and boards have to continually evolve, adapt and restructure. Strategic boardroom succession planning provides opportunities to evolve and refresh the board with new and needed skills as the economic and competitive landscape changes—and to increase the diversity of perspectives. When approached thoughtfully, ongoing board renewal can improve board effectiveness.

The nominating/governance committee plays a critical role in analyzing the board's needs over time and planning accordingly. Just as with CEO succession, planning ahead enables boards to widen the net, increase their options and secure the very best talent at the time when it is most needed.

There is growing recognition that boards with a good mix of age, experience and backgrounds tend to foster better debate and decision making and less groupthink. More and more directors say thoughtful succession planning can improve the composition and effectiveness of their boards.



THREE KEY STEPS FOR BOARD SUCCESSION PLANNING

Analyze	Prioritize	Plan
<ul style="list-style-type: none"><li>• What is the company's strategy over the next five years and how does it impact the skills, composition and demographics needed in the boardroom?</li><li>• What is the expected boardroom turnover over the next five years, and what gaps will these departures create?</li><li>• Does the board have the right mechanism (e.g., mandatory retirement age, term limits, evaluations of some kind) for triggering departures and board renewal?</li><li>• How well does the current board composition and culture align with the company's direction?</li><li>• How does the board benchmark against key competitors and how should it evolve?</li></ul>	<ul style="list-style-type: none"><li>• What is the preferred cadence for change in the boardroom? Is the board comfortable adding more than one director at a time?</li><li>• How should skills and qualifications of new directors be prioritized?</li><li>• What combination of desired skills and qualifications are most likely to result in a successful search?</li><li>• What skills and qualifications are in heavy demand in the boardroom and warrant prioritization?</li></ul>	<ul style="list-style-type: none"><li>• What is the optimal timeline for adding new directors?</li><li>• What is a realistic timeline for recruiting new directors?</li><li>• How should onboarding be structured to best position new directors for success in the boardroom?</li></ul>

# For More Information

This paper is an excerpt from the Nominating/Governance Committee Fundamentals Guide, a comprehensive guidebook created for Corporate Board Member's Board Leadership Program with content provided by Spencer Stuart's North American Board Practice.

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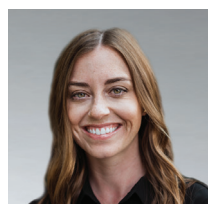
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