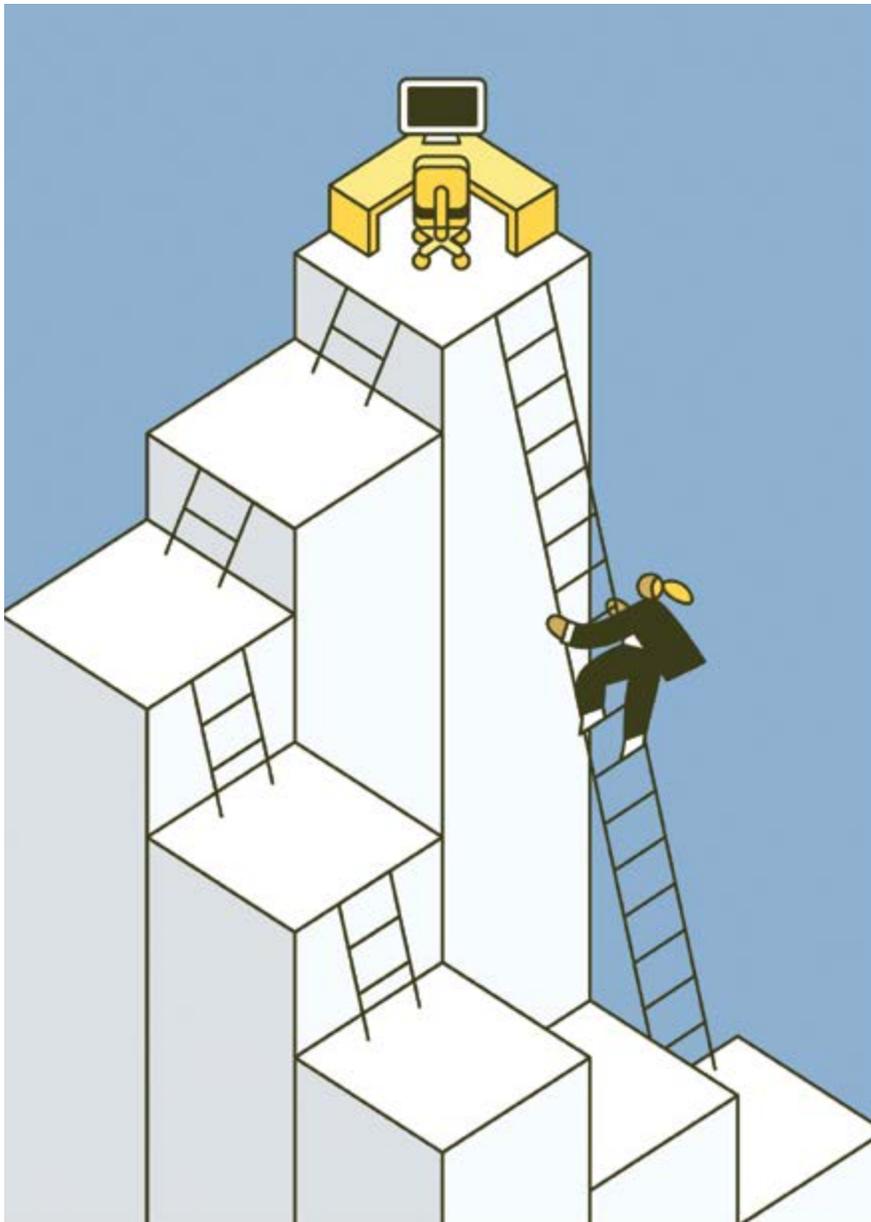




Idea Watch



Finding the Right CEO



IN THEORY

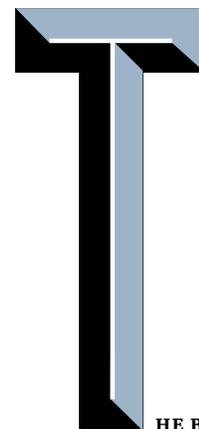
Finding the Right CEO

The most promising candidates in your company may not be where you expect.



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New Research and
Emerging Insights



HE BEST

STEPPING-STONE to the corner office is changing. The vast majority of new CEOs still come from within: For example, in 2020, 77% of new S&P 500 CEOs were internal promotions. But whereas 20 years ago chief operating officers were the overwhelming favorites, accounting for 76% of such appointments, they have lost significant ground and look to be overtaken soon by another group of aspirants: division heads. According to a new study, however, neither cohort is the most likely to deliver outstanding results. “Leapfrog CEOs”—leaders appointed from one level below C-suite officers or division heads, with titles such as senior vice



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president and general manager—have the best odds of steering their firms into the top quartile of performers.

A NEW FOCUS ON COMPLEXITY AND OPPORTUNITY

As part of a large ongoing study of CEOs, researchers from the executive recruiting and leadership advisory firm Spencer Stuart analyzed every CEO succession in the S&P 500 since 2000. The waning numbers of COOs tapped for the top job reflect changing strategic priorities, they say. “The role of COO was popularized in the 1990s as a result of management trends around quality—*kaizen*, total quality management, Six Sigma, and so on, when the leadership emphasis was on operations,” explains Claudius Hildebrand, the head of CEO data and analytics at Spencer Stuart and a coauthor of the study. But in recent years companies have become flatter, and power has moved from functions to business units. What’s more, boards have come to prioritize experience running a full P&L. “Divisional leadership positions combine the benefits of managing complexity with the experience of spotting opportunity and market trends,” Hildebrand says.

In 2020—the last full year for which data is available—chief operating officers accounted for 38% of new CEOs in the S&P 500. Division heads were only two percentage points behind them, at 36%. Chief financial officers were next, at 9%. CFOs appeal to boards that want to ensure continuity, because they often serve as right hand to the CEO. Leapfrog candidates—the final group with significant representation in the



study—accounted for roughly 5% of new chief executives.

Having identified where successors came from, the study looked at company performance after they assumed the CEO role. The researchers sorted the executives into quartiles based on their company’s market-adjusted total shareholder returns. The least-common choice, the leapfrogs, had the highest share of CEOs in the top quartile for performance: 41%. Former division heads and COOs were next, at 27% and 25%, while the share of CFOs in the top quartile of performers was only 8%. Leapfrogs were also less likely than CFOs—ostensibly a safer pick—to end up in the bottom quartile, despite their lack of C-suite experience. The patterns

were consistent after controlling for industry differences as well as organizational and market attributes and for pre-Covid performance.

Although the researchers didn’t quantitatively analyze reasons for leapfrogs’ superior performance, they have some theories based on follow-up interviews and their consulting experience. In assessing candidates—even at the CEO level—it’s often better to value skills and ability over experience, they contend. “When directors choose a leapfrog, they are choosing potential,” says Robert Stark, a colead of Spencer Stuart’s CEO succession advisory services and a contributor to the study. “They are betting that the candidate has the capacity to do much more than



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they've already demonstrated. It speaks to what sort of game you're playing as a board: Are you playing to win, or are you playing to not lose?"

This isn't to say that boards should elevate only leapfrogs. "We could point to highly successful CEOs from every role," Stark emphasizes. "Each CEO succession is different." Instead, the study's findings indicate that boards should build relationships deeper down in their organizations—something few have traditionally done. Indeed, a 2014 study by the Conference Board, the Institute of Executive Development, and Stanford's Rock Center for Corporate Governance found that most board members lack detailed knowledge of the skills, capabilities, and performance of executives even one level below the CEO. Only about half of the directors surveyed reported understanding the strengths and weaknesses of those executives very well or well. And rarely—in just 7% of companies responding—was a board member formally assigned to liaise with them. Talent further down in the organizations gets even less attention. "Boards need to be actively participating in their organizations' talent development process," Hildebrand says. "They need to know the unlikely candidates just as well as the likely candidates and expand their consideration set of potential CEOs."

The researchers believe that a more expansive approach to the succession search could benefit firms in another way: by boosting their diversity, equity, and inclusion efforts. Minorities and women are badly underrepresented in all four of the main CEO stepping-stone roles, but they are more common at the leapfrog level.

GETTING TO THE NEXT LEVEL

Finally, the researchers hope their work will help executives as they develop the capabilities and experience needed for the top job. After conducting a meta-analysis of 100 CEO aspirants, the study identified development opportunities for leaders in each of the stepping-stone roles: COOs can best position themselves for success by building a following across the organization and being more visibly present to the broader workforce, and division heads should expand their vision and understanding of the business at the enterprise level by, for instance, volunteering for companywide projects. CFOs will probably benefit from gaining operating experience outside finance, while those in leapfrog positions should seek exposure to analysts, investors, board members, and other external stakeholders.

Ideally, firms' talent-development process would provide such opportunities, says Seonaid Charlesworth, a Spencer Stuart consultant and one of the study's coauthors. "In reality," she adds, "CEO aspirants may need to seek them elsewhere, by making lateral moves inside or even outside the firm if they feel blocked in their current role." For the time being, heading up a corporate division is most likely to put a candidate in a prime position to become CEO. ©

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 **ABOUT THE RESEARCH** "The Last Mile to the Top: Future CEOs Who Beat the Odds," by Claudius A. Hildebrand, Robert J. Stark, and Seonaid Charlesworth (white paper)

IN PRACTICE

"It's Easy to Play Defense with Such a High-Stakes Decision"

Lucien Alziari is the chief human resources officer at Prudential Financial. He has been closely involved in CEO selections at three global companies, including the 2018 appointment of Charles Lowrey at Prudential. Alziari recently spoke with HBR about the succession process. Edited excerpts follow.

Spencer Stuart research suggests that leapfrog CEOs—people promoted from one level below the C-suite—outperform, but they make up a minority of CEO appointments. Should more of them be named to the role?

I'd be cautious with that conclusion. Many boards do not consider leapfrog candidates to begin with, so candidates have to be truly exceptional to even be part of the process. And selection bias might be skewing the success rate when compared with other launchpad roles. But the data offers a good reminder

to boards not to become too risk-averse with CEO choices. It's very easy to look for reasons to disqualify a candidate, such as lack of experience, rather than to focus on the towering strengths that might make somebody a differentially better choice. It's easy to play defense and forget about offense with such a high-stakes decision.

Divisional leaders are set to overtake COOs as the most common choice for CEO.

Why is that?

For a while execution was the priority for CEOs, but in recent years the need for strategic leadership has been reemphasized. With the dislocation caused by the financial crisis and now the pandemic, CEOs are having to ask existential questions about their firms and how they will survive and prosper in a changing environment. People who come up through the ranks as business operators—COOs—don't typically have all that in their DNA.

What was Charles Lowrey's profile before becoming CEO?

Charlie fit the divisional CEO mold. He ran Prudential's international businesses and before that the domestic and asset management businesses. He reported directly to the chairman.

Division heads are really micro versions of a corporate CEO. They don't have some of the external obligations that a corporate CEO has, but they face all the strategic challenges of running a large, complex business. They're also managing execution, culture, and talent. It's a pretty good test of what you want in a corporate CEO.



Will you draw on the research's findings in the next CEO search that you participate in?

They are certainly helpful. Of course many other factors are important in addition to each candidate's current role. By the time executives get to the last launchpad before becoming CEO, they're the product of years of development by the company along

with their own self-development and maturation.

What would you advise the board to look for when the time comes?

It depends on the role and the circumstances. But one thing that is top of mind for me now is the stronger public profile of CEOs. They increasingly need

to be the voice of the company; they are required to comment publicly on broad social issues and navigate hot-button political issues, bringing employees along with them while satisfying other stakeholders.

You can't do any of that without a combination of strong communication skills and personal empathy. ☺