CEO SUCCESSION PLANNING FOR SILICON VALLEY COMPANIES

Spencer Stuart recently hosted a wide-ranging discussion on CEO succession planning for Silicon Valley companies. It featured a panel of three experts who offered unique perspectives informed by their impressive experience in both CEO and board director roles:

Dan Warmenhoven, executive chair and former CEO of NetApp; former chair of Redback Networks; and current board director at Aruba Networks, Bechtel Group and Stoke

Judy Estrin, CEO of JLabs; co-founder of seven technology companies; author of *Closing the Innovation Gap*; former board director at FedEx, Sun Microsystems and Rockwell International; and current board director at The Walt Disney Company and Packet Design

Bill Campbell, chair and former CEO of Intuit; longtime adviser to many Silicon Valley companies; and current board director at Apple, Columbia University and the National Football Foundation and Hall of Fame

THE UNIQUE WORLD OF TECHNOLOGY COMPANIES

In considering the succession issues facing technology companies, the panelists were quick to point out that Silicon Valley companies are unique in many respects relating to CEO succession. In some Silicon Valley companies whose ultimate goal is to be acquired, directors may not even see CEO succession as a priority. "I'm on a number of boards where I don't think it's appropriate for the board to spend any time on CEO succession because the probable outcome for the company is that it's going to be sold," said Warmenhoven. "For a small, single-product company, the requirements on the board and the need for succession planning are quite different than they are in a much larger, much more diversified company."

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Other technology company boards make succession planning an ongoing focus. But even these companies sometimes face greater challenges than nontechnology boards do in succession planning because of their often-quick growth trajectories. Estrin defines this growth path in three stages. Phase one is where the company goes from inception to manufacturing a product, and requires a CEO who is great at vision and comfortable with ambiguity and taking a product to market. Phase two is about establishing initial markets and getting the first 50 or 60 customers. The third phase, growing the company, requires a "scale-it CEO" who is great at scaling and operations. "Rarely can a person do all three," said Estrin. "Very often, the CEO who starts it may not be able to scale it and the CEO who scales it may not be able to deal with early-stage ambiguity."

According to Estrin, it's also harder for leaders from other industries to cross over and lead a technology company. "The CEO needs to have some technology understanding and expertise to be a good CEO," she said. "If a CEO has none and comes into the industry, it is very hard for them to understand the jewels of the company. A great operations person at FedEx can carry that expertise over to other operationally-oriented companies. But that's harder to do in the tech space."

SUCCESSION PLANNING FOR STARTUPS

CEO succession in Silicon Valley is also unique in that the majority of companies in the region are smaller startups that are organized along functional lines. According to Warmenhoven, "This makes it harder for Silicon Valley companies to develop all the skills a future CEO will need from a succession perspective, as opposed to S&P 500 companies, which are organized more into business units with real P&Ls and general managers."

In fact, the boards of startups almost always look outside the company for a successor CEO, since they are too small to have a strong executive bench. "I cannot think of a private company board I've been on, with the exception of Bechtel, that is thinking about an internal candidate as a possible CEO successor," said Warmenhoven, "and I should point out that in the history of Bechtel there have been four CEOs and their last name is always Bechtel. Startups just don't have that kind of breadth — I've never seen a situation where a company that's small and privately held had two qualified CEO candidates at the same time."

EIGHT BEST PRACTICES FOR CEO SUCCESSION

Over the course of the event, the panelists shared several succession-planning best practices they have uncovered over their many years of serving on public and private boards that apply to a variety of industries. Among them were these eight guidelines for board directors:

1 **Be clear on the board's role in succession.** "The role of the board is to hire and fire the CEO," said Campbell. "While you can advise the CEO about things that the board is concerned about, and things like talent development, they've got to do it themselves. If you don't like what they're doing, you've got to get rid of the CEO. But you can't micromanage a CEO from an operational perspective, ever."

2

Define the current CEO's role, as well. "I was the co-founder and CEO of a medium-size company, and decided that I wanted to step down as CEO and had to replace myself with someone from the outside," said Estrin. "The board decided they trusted me to do that with very little involvement, and I have to admit that I did a terrible job. I replaced myself with someone who looked great and ended up being a disaster. That taught me that CEOs should be very involved in succession planning and certainly with internal candidates, but that it's hard to step back and have the broad perspective needed to bring in someone new if there is no good internal candidate. Board members need to be involved in that decision."

3

At a minimum, explore the two main succession scenarios. "I've been in companies where there were two levels of succession planning," said Campbell. "One level is, 'Who comes in if the CEO gets hit by a bus?' The other is long-term succession planning. It is incumbent on the board to prepare for both."

4

Have the CEO and HR teams report on their succession plans. "They should be able to present that to the board once a year with a full talent review," said Campbell. "It pushes them to understand that if I lost my manufacturing guy, who is next? If I lost my finance guy, who's next? A board has to pay attention to that, and to make sure that it's covered and not exposed if somebody leaves or gets hit by a bus."

5

Get to know the talent under the CEO. "I think this is very important," said Estrin. "There are two ways to get to know the talent. One is through having them present at board meetings. Another is if the CEO encourages board members to periodically meet with different people on their staff on specific topics."

6

Provide an oversight role in candidate development. "As soon as board members start getting involved in the training and development of a particular individual, they've overstepped their bounds and now are in an operational role," said Warmenhoven. Added Campbell, "I don't think we should be involved in making sure that they get management training, but if you're bringing people along, you want to get them exposure to the board, to broader sets of experiences, and you want to move them across different functions."

7

Avoid the horserace. "In most companies, a horserace leads to dysfunction among the executive team, and the competition itself can be detrimental to company performance," said Warmenhoven. According to Campbell, "The last thing you want to do is do what GE did years ago with Immelt — one guy won and four or five guys quit. If they hadn't made it a horserace, they might have been able to keep some of those other people in significant jobs, something you want from a management continuity perspective."

8

Don't name a successor explicitly. "I think there's a certain amount of proving to be done and performance to be evaluated before you say, I'm really comfortable with him taking on the next level of responsibility," said Warmenhoven. "Once you name somebody, you've essentially said he's it, and I think the evaluation process goes away too. I don't think that's very healthy. My view is that who the successor is should be the purview of the board in its private session, and the name shouldn't be put on anything that's a discoverable document."

WHAT TO DO WITH THE OUTGOING CEO?

One highlight of the conversation was the panelists' discussion of whether to retain the outgoing CEO on the board as a director or executive chair at a time of CEO transition. As with many succession-related considerations, they agreed that it depends on the situation. "Sometimes, you want to get the outgoing CEO out of the company," said Campbell. "If things haven't been as good as you would want them to be, you want to change the whole culture and have it be the new person's. On the other hand, some outgoing CEOs are older, wiser, more nurturing and coach-oriented — and can really help the CEO."

According to Estrin, only an outgoing CEO who is able to move out of the spotlight without micromanaging or signaling by their body language that they disagree with the CEO should remain on the board. Also worth considering is whether the two individuals have a mentorship relationship — something that may seem positive, but that can actually create an unhealthy dynamic.

"When you promote someone to CEO, they need to act differently," said Estrin. "They need to step up and be the CEO, and if their mentor is still in the room, it's kind of like a parent going off to college with their kids. Sometimes, having the CEO become executive chair works beautifully. Other times, it can prevent the new CEO from becoming a great CEO."

THE SPECIAL CASE OF THE FOUNDER CEO

According to Estrin, keeping an outgoing founder CEO on the board can be a best-case or a worst-case scenario. "Very often, the founding CEO has the loyalty of people who have been there from the beginning and it can be really important and work really well," she said. "But if the company needs to change, having the founder on the board with that passion, vision and loyalty of the team can backfire. You can end up with a division and dysfunction on the board, and that is really dangerous to the company. It's a tricky issue, because the founder is often still a very large shareholder."

This ownership stake and overall personal investment is part of the reason that keeping the founder on the board can often work very well. "I think that the most successful cases have been where there is a founder CEO who built the company and is interested in his or her legacy being sustained in the next generation," said Warmenhoven. "The founder has more of a stake in the outcome of seeing the firm continue to sustain and be successful because it's in their personal best interest. That's not always the case for someone who has taken over an institution that's been around for a number of years."

STRUCTURING THE SUCCESSION-READY BOARD

To build a board that can tackle succession issues effectively and function efficiently, the panel offered three suggestions:

1 **Think small.** "The smaller the board, the more effective it is," said Campbell. "You need three

audit committee members and two for the compensation committee. If you want to run those meetings in parallel, you need five directors. Add the CEO for the sixth and you're done. The bigger the board, the more convoluted the discussion is."

2 **Embrace diversity.** "The most important thing is not to have a checklist definition of diversity, but to have cognitive diversity," said Estrin. "A board that has people from different backgrounds and different ways of thinking can bring the most to the CEO and to the company. A board that interacts well together and comes from different perspectives actually brings more value. It asks better questions; it has different sets of connections. To me, the worst boards are the ones where you walk in the room and every board member looks the same and comes from the same background. Those boards are less likely to be helpful to the CEO."

3 **Keep a former CEO who becomes chair separate from the company.** "When I left Intuit as CEO, I didn't want to be on campus as chairman," said Campbell. "I didn't want people to come in and commiserate or whine to me about why things changed. I stay on the other side of the Valley and go to the company for a formal meeting every other week, but the rest of the time it's just informal based on what the CEO asks me to do. If you're going to be the chair, get out of the building. If they want you, they'll call you."

Throughout the discussion, the panelists offered their perspectives and advice on a variety of CEO succession topics. But they also reinforced the idea that CEO succession involves so many variables that it remains more art than science, despite an ever-growing focus on corporate governance best practices.

"Good CEO succession comes down to planning, talent development and having a functional board," said Estrin. "There's no formula for how this gets done. If you're sitting in the boardroom looking for data to help you make that decision, you've got the wrong set of board members. Like a lot of leadership decisions, much of it is instinct and judgment and understanding the specific situation of the company."

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