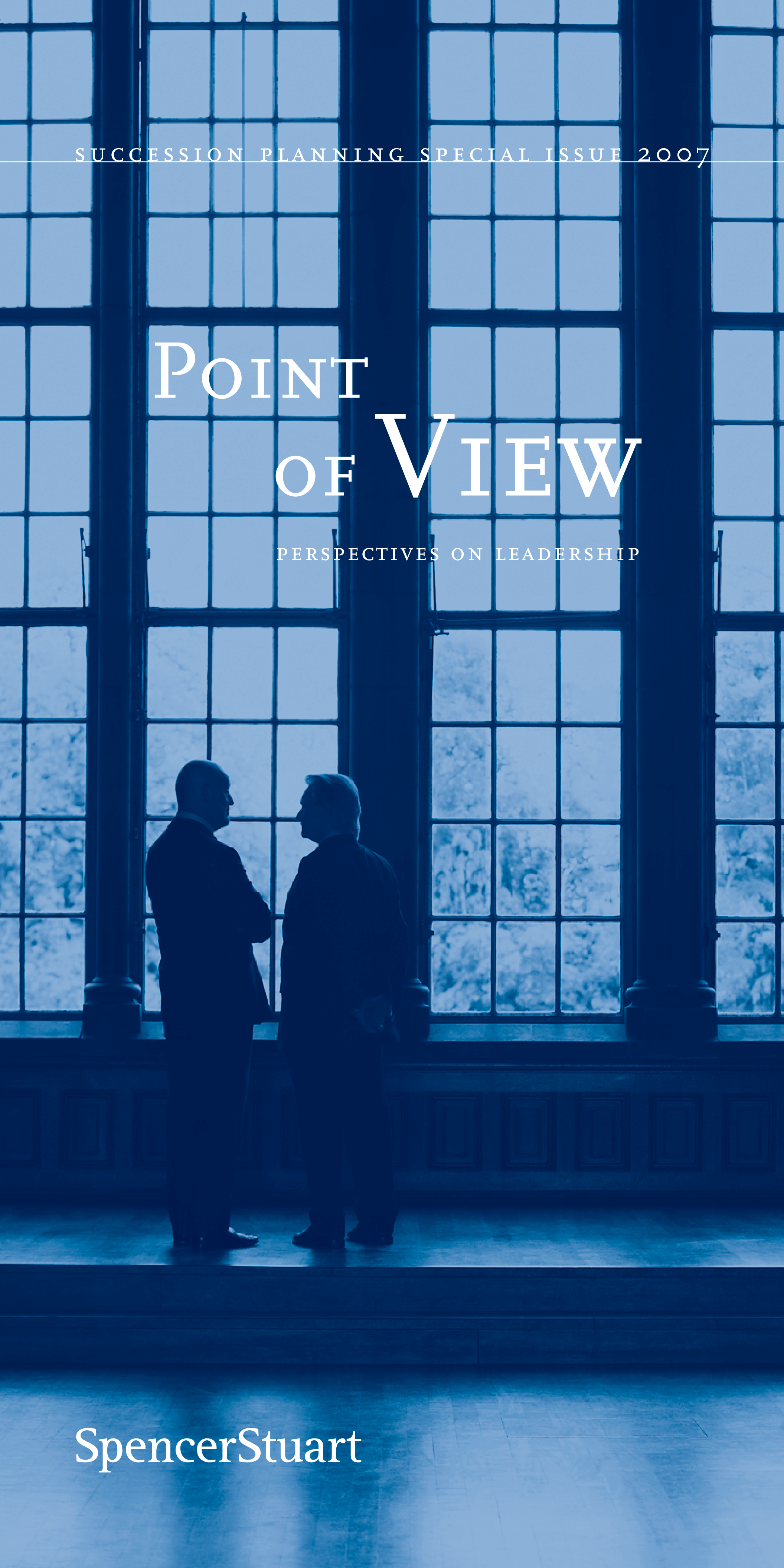
SUCCESSION PLANNING SPECIAL ISSUE 2007

POINT OF VIEW

PERSPECTIVES ON LEADERSHIP



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Historically, boards allowed the chief executive officer to take the lead in filling board seats or tended to replace a retiring director with an individual "who looks like the person who left." Today, of course, boards no longer cede responsibility for director recruitment and succession planning to the CEO, yet they typically address director succession only on an as-needed basis — when facing an impending vacancy.

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It is an issue many CEOs wrestle with: how to do the right thing for one's company while also doing right by oneself. When it is time to move on, how can a CEO manage the transition to the next phase of his or her life in the most responsible way with the least negative impact on the company?

"When you're dying of thirst, it's too late to think about digging a well."

— Japanese proverb

Facing the sudden departure of the chief executive officer, too many boards have discovered too late the wisdom of this proverb's message. While corporate boards and CEOs embrace succession planning as one of their fundamental responsibilities, many find it among their most challenging. History demonstrates that the modern-day director is not alone in being challenged in this area. In fact, succession has preoccupied and bedeviled cultures around the world for centuries. Throughout the course of history, sons and fathers have clashed, wars have been fought and schemes have been plotted, all in the name of finding the right — or rightful — leader. Thankfully, boards can avoid such drama through careful and ongoing planning.
Knowing how challenging the topic can be for boards, we have set out with this issue of *Point of View* to reflect on and provide insights about a number of issues related to planning for the succession of the CEO, top executives and board directors. As always, we welcome your comments about this issue.

David S. Daniel

Chief Executive Officer

Spencer Stuart

Navigating the barriers to CEO succession

Dayton Ogden, Spencer Stuart — Stamford

It is only relatively recently that the task of actively managing the CEO's succession has become recognized as a foremost priority for U.S. boards. With some notable exceptions, many boards are falling short of their responsibility to plan rigorously for a smooth transition at the top.

A number of factors have combined to bring the issue of leadership succession to the fore. First, corporate governance reforms have raised the level of accountability for executives and independent directors alike, making it more difficult to survive a period of poor performance. Second, these same reforms have empowered shareholders to take a more active stance against management failings and boards that do not rectify those failings. Third, the primacy of the CEO in the boardroom has been lessened by the emergence of the lead independent director and, in certain cases, by the appointment of a separate chairman to lead the board. These factors have made the CEO far more vulnerable than in the past.

CEO tenure is getting shorter, but it is not just the CEO who is vulnerable. The early, unexpected departure of a CEO often has a negative impact on the company's share price, as investors speculate on how effective the replacement will be and whether the board is competent to restore stability to the organization. A well-thought-through succession plan will, however, go a long way toward mitigating the negative impact of a CEO's departure.

Perhaps surprisingly, the only corporate governance regulation covering CEO succession appears in Section 303A of the NYSE Listed Company Manual, which states that every company is required to adopt and disclose its own corporate governance guidelines. The manual includes management succession as one of seven subjects that must be addressed in these guidelines:

> *Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.*

With the number of CEO departures in North America on the increase, CEO succession has become of paramount importance.[1] Yet our experience is that some boards are still reluctant to face the issue head on; the gap between intention and execution is sometimes conspicuously wide.

How, then, should boards respond to the succession planning challenge? The ideal scenario is that of a stable company, performing at or above market expectation, whose board takes a well-planned, long-term view of succession and has created the right environment to identify, develop and retain its future leaders. In reality, this rarely happens; no company — even one with a sound long-term succession plan — can afford to be complacent or can escape the possibility that short-term, urgent succession activity may be necessary. A CEO may decide, due to illness or for other personal reasons, to leave earlier than planned, in which case a short-term solution will be needed.

Some boards focus properly on succession only when faced with a performance crisis, in which case it is probably too late — they will almost certainly have to look outside the organization for a replacement CEO. Whatever the situation, a board's ability to handle succession will depend on a combination of structural and psychological factors. So what are the barriers preventing boards from dealing effectively with the issue of CEO succession?

Barriers to CEO succession

Board distractions

Boards have to strike a balance between focusing on matters of immediate concern and considering the long-term goals of the organization. Priority is inevitably given to what appear to be the most pressing issues, such as corporate governance, financial probity, strategy development, M&A, quarterly performance, shareholder demands, CEO compensation — often at the expense of succession planning.

A sensitive subject

Communicating the need for succession planning is psychologically complex and requires delicate handling. Many boards are simply uncomfortable raising the issue for a variety of reasons. They may regard it as insensitive to put succession on the agenda when the CEO is relatively new in the role, or they may be reluctant to exacerbate the pressure a CEO is already under, by asking him to think about his successor.

"The truth is that, as a business evolves, the requirements of its CEO also can change."

The reluctant CEO

The CEO who exerts an overly powerful influence in the boardroom is likely to make it difficult for other board members to raise the issue of his or her succession. Such a situation calls for a strong lead director to ensure that the topic is not overlooked. The more self-confident and politically astute CEO will embrace the development of a succession plan, and participate actively in securing leadership continuity in the best interests of the business and all its stakeholders. However, our experience is that CEOs sometimes are reluctant to raise the topic of their own succession.

The truth is that, as a business evolves, the requirements of its CEO also can change. At some point the experience and ability of the current CEO may not be sufficient to steer the business through its next phase, and so a different set of leadership skills may be needed. This can be difficult to accept, especially for someone wedded to the power and prestige that comes with the top job. However, as others have pointed out, a CEO's true legacy is determined by what happens to the company after he leaves office. Those CEOs who recognize that they are not weakening their position by embracing the succession issue are doing themselves a favor, as well as benefiting a broad range of stakeholders.

Complacency

Many boards think they are doing well, yet their definition of a good succession plan is often inadequate. Board members may find themselves too close to the CEO, lacking a sufficiently independent or objective mindset necessary to tackle the subject effectively. In addition, the board may not have sufficient experience in overseeing a succession plan. It is good corporate governance for a board to contain at least one person with firsthand experience of senior-level succession planning.

Lack of objectivity

When boards do turn their attention to CEO succession, it is a mistake for board members to rely solely on their own subjective views of possible contenders. For example, there is a commonly held preconception that internal candidates are saddled with too much baggage, unable to approach the challenge of the CEO's job in a fresh manner, or that external candidates lack crucial product knowledge and credibility with customers. Both views can be grossly unfair to potential contenders.

A good starting point is to undertake an objective assessment of potential succession candidates, both inside and outside the organization. In case the CEO has not been entirely forthcoming or accurate in his assessment of senior-level reports, many boards find it extremely helpful to retain external advisers who can conduct a thorough benchmarking exercise early on in the process. Benchmarking potential succession candidates against the best leadership talent outside the organization brings a crucial element of objectivity to the process and ensures that no one is overlooked in the search for a new CEO.

Lack of agreement about the specification

When succession plans fail, it is often because a board does not understand the characteristics of the ideal candidate. The board cannot make a good decision about the future leader without first agreeing to a clearly defined specification for the future CEO role. That spec must take into account the vision of the company, its long-term strategy and any developments taking place in the industry sector. Without a comprehensive spec to work from, the board is going to find it extremely difficult to make the right decision.

"No one should be in any doubt that this will involve a serious time commitment."

Lack of CEO-ready talent on the inside

Not all companies will be blessed with a crop of potential successors with the talent and experience to assume the CEO role within the given time frame. Demands on CEOs are increasing all the time and, as a result, fewer people are qualified to step into the top role. This is particularly true in organizations comprising few lines of business or little diversity of offerings, where the pyramid of potential successors can be quite narrow. Particular effort must be made to nurture and develop talent in an organization where there are fewer opportunities to put people into general management roles.

CEO-ready talent is more easily found inside a multinational, multi-industry company. This is borne out by the 2006 Corporate Board Member Survey, *What Directors Think*, which found a correlation between the size of a company's revenues and the board's satisfaction with management succession. Potential CEO successors tend to learn general management skills in multi-industry companies such as GE, where there are abundant opportunities for high-fliers to run parts of different businesses at an early stage in their careers. Of course, there are no guarantees, even in these larger businesses — many of the leadership skills required of a CEO are unique to the top role and therefore not easily learned.

The threat of losing good people

Some boards will ask themselves whether openly executing a succession plan is worth the risk that disappointed contenders may decide to leave. For most organizations the loss of a couple of leading figures will be devastating and every effort should be made to avoid this happening. How the board and CEO manage communications with senior executives is critical; if it becomes widely known that there are two or three potential successors to the CEO, people inside the organization may split into camps and this can have a deleterious effect on the culture.

Navigating the barriers

As we have seen, there are a number of barriers that boards must overcome before they are able to develop and implement an effective CEO succession plan. Many of these barriers are psychological, involving perfectly understandable fears, perceptions and sensitivities. The fact that these "soft" factors so often interfere with the task suggests that many boards lack a formal framework for succession planning.

The most effective way to overcome these psychological barriers is to create a mechanism that will enable board directors to apply themselves to the task of succession planning in an objective, emotion-free manner. A robust process matters as much for succession as it does for audit, board nominations and compensation. Indeed, it could be argued that without such a process in place, the board is neglecting its fiduciary responsibility.

"Institutional investors need to have confidence that the board is taking care of succession but do not need to have any further window on the process."

One solution is for the board to set up a committee with explicit responsibility for overseeing the CEO succession planning process. With a mandate to look at short-, medium- and long-term scenarios, the committee membership should be well balanced and capable of covering this task effectively.

The more "matter-of-fact" the process, the less alarming it will be for everyone concerned, including the CEO. Ideally, of course, the CEO would participate actively and enthusiastically in finding his or her successor, but in any case the existence of a committee will ensure that the board is not reliant on the CEO to raise the topic.

No one should be in any doubt that this will involve a serious time commitment. However, the presence of the committee increases the likelihood that board members will invest the time to get to know the pool of potential successors personally. Its value in guiding the board to the right decision, ensuring an orderly transition of power and keeping all the internal candidates motivated can be substantial.

Both the current CEO and the senior human resources officer will have a role working alongside the committee, as will outside consultants who can provide benchmarking and assessment services and potentially act as a catalyst or facilitator for board-level discussion on the topic.

Alternatively, some companies may favor a less formal, more ad hoc approach, creating instead a "task force" of interested directors with no charter. The danger with this approach is that an informal task force might be perceived as acting under the radar, perpetuating the stigma associated with succession planning — making it seem like a delicate topic. Whatever its title, the very existence of a formal board entity sends out an important message about the routine nature of the succession planning process, and automatically overcomes any reluctance to raise the issue in the first place.

To avoid rumor and speculation and to minimize the effect on the company's shares, the board should exercise particular discretion over CEO succession planning. If a proper relationship exists between board, management and shareholders, the latter should be satisfied in the knowledge that a well-thought-through process is in place and in the hands of qualified directors. Institutional investors need to have confidence that the board is taking care of succession but do not need to have any further window on the process. Similarly, the board must communicate whatever process is in place, but should not feel compelled to divulge particulars.

Finally, it is vital that the successor to the post of CEO is suited to lead the company of the future, not the company as it stands today. The first step towards framing a succession plan is likely to be the board retreat, when directors focus on long-term strategy. With the strategy in place, and a vision for what the company will look like in five to 10 years, only then is it possible to create the spec for the future CEO and start the identification process with confidence.

About the authors

Dayton Ogden is a former chairman and managing partner and currently coordinates the firm's CEO search activities. He also is a member of the Board Services and Industrial practices.

Footnotes

1. A study by Chuck Lucier, Paul Kocourek and Rolf Habbel of Booz Allen Hamilton, "CEO Succession 2005: The Crest of the Wave," showed that CEO turnover in North America rose from 12.9 percent in 2004 to 16.2 percent in 2005.

An insider's view of succession planning: the separate and joint responsibilities of the board and CEO

Jim Citrin, Spencer Stuart — Stamford
Tom Neff, Spencer Stuart — New York

In the somewhat more innocent times of the recent past, CEO succession may not always have been done well, but at least everyone knew the role he or she had to play. Typically, the CEO led the process, making all the major decisions about not only who the successor would be, but the timing of any transition. If the choice or the timetable was not optimal, the board rarely acted to override the CEO's decisions and tread on what was perceived as the CEO's turf.

Things are not so simple anymore. Systematically planning for a capable successor to the CEO is now considered so critical to the ongoing success of the enterprise that it is no longer deemed proper or prudent to leave it completely in the hands of the CEO. While succession planning is viewed as a shared responsibility between the CEO and the board, it ultimately falls squarely within the board's realm — as well-planned and well-executed succession is so critical to maintaining investor confidence. In fact, it is considered one of boards' highest-priority duties and is increasingly scrutinized by outsiders, including organizations that compile board performance metrics.

Preparing for different scenarios

Since succession planning can be a complicated bit of choreography it is a good idea to map out specific roles and responsibilities for the board and CEO to ensure a thorough approach while, at the same time, avoiding overlap.

There are myriad ways in which CEO succession may play out. For planning purposes, it is prudent to cover and address the broad categories below, where the degree of CEO involvement ranges from active to none at all.

Logical succession
A core plan based on the age and future plans of the current CEO, which includes internal and external candidates and plans for the development of the internal group.

Emergency succession
A contingency plan developed to deal with an unexpected event that could force a sudden succession, including a health crisis or the CEO's departure to another company. This plan would identify an acting CEO such as a board member, senior executive or retired executive who could step in immediately.

Accelerated succession
A plan that the board would be able to implement if it has concerns about the performance of the company and/or its relationship with the CEO.

Maximum CEO involvement: Logical succession

The core to establish and build around for any board that wishes to achieve excellence in succession planning is the logical succession planning scenario. This is also, typically, the scenario where it is appropriate and desirable for the CEO to have a significant degree of input and involvement.

What we call the logical succession scenario, now deeply embedded at many leading companies, is a well-tuned process, which may unfold over the course of a number of years. During that time, the CEO and board work as a team to ensure the development and readiness not just of a successor CEO, but also the bench of executives for all key management positions throughout the organization.

It is never too soon to start this sort of succession planning, and it ideally is institutionalized as a routine process in just the sort of circumstances where one might assume succession planning is not required at all; that is, in situations where both company and CEO performance are proceeding well. At companies that do not just pay lip service to succession planning but practice it day in and day out, the senior human resources executive is a key player in integrating best practices and keeping the planning process moving.

In fact, it is when things are going well that both the CEO and the board have the luxury of carrying out succession planning and related management development as it should ideally be done. While the CEO and his or her team have day-to-day responsibility for succession planning, there should be regular interaction between the CEO and the board to assess the company's succession readiness. The CEO maintains an overview of the entire management chess board, so to speak, both assessing what may be needed for the organization in terms of leadership as well as individual managers' future prospects.

"The benchmarking process may help to highlight areas where internal candidates still need to enhance skills, or possibly even add capable outsiders to the succession slate."

A CEO who is practiced at longer-term succession planning recognizes that it is linked inextricably with management development, and is always thinking several steps ahead. This is necessary to ensure that there is time to round out the development of high-potential managers, whether or not they are viewed as future CEOs. With a process that anticipates shifts in the competitive environment and strategy, the board ultimately has greater flexibility and, ideally, choices when it is time to select the next CEO. A process that is truly systematic about succession planning includes an assessment of each key position, and seeks to identify both immediate back-ups and individuals who may be ready to step in within a one- to three-year time frame. Depending on how critical a given position is, recruiting from the outside may be necessary to make sure the pipeline is filled with the right potential candidates, factoring in the time required to address any development needs.

Directors need to ensure that there is a rigorous process in place so that the board is getting feedback on progress, particularly on potential successors to the CEO. In most companies where the CEO and the board have a good working relationship, and where succession is a deeply ingrained process, there is an ongoing conversation about succession. In this scenario, the board is never left guessing about succession planning progress, but builds updates from the CEO, as well as exposure to potential successors, into the agenda of each board meeting.

“An individual’s goals can shift over time, and so can the company’s strategy.”

Boards have become more active on the topic of succession generally, and specifically when the window for a CEO retirement narrows to between two and three years. At this point, it is appropriate for the board’s involvement in the process to escalate as it becomes more engaged with potential successors, perhaps even considering whether to increase their responsibilities in certain areas, and encouraging participation in an outside board. The board should make it a priority to get to know high-profile potential successors and create opportunities to get to know them in a way they have not been able to previously. Before a formal succession plan is set in motion, the board needs to determine whether the process is on track toward the right solution. If the board is homing in on one or more individuals, it also needs to confirm that those individuals are interested, especially if planning is taking place over a protracted period.

An individual's goals can shift over time, and so can the company's strategy. In assessing any finalists for a planned succession that may be only a year or two away, it is critical that the board and CEO carefully reflect on the strategy going forward as well as the skills and experience required to execute it. This can help to narrow the selection process among seemingly equally qualified successors, and also allow for any additional development of skills and experience that is deemed necessary. What begins as an informal assessment intensifies and becomes more formalized as a planned succession date draws nearer, until it becomes a regular agenda item for the board in executive sessions.

"At this point, it is appropriate for the board's involvement in the process to escalate as it becomes more engaged with potential successors, perhaps even considering whether to increase their responsibilities in certain areas, and encouraging participation in an outside board."

As a CEO transition nears, the board naturally will take over the reins from the CEO, and may want additional outside confirmation that it has made the best choice for the company. We often work with boards at this stage to benchmark a select group of external candidates with relevant experience. The benchmarking process may help to highlight areas where internal candidates still need to enhance skills, or possibly even add capable outsiders to the succession slate.

The board takes the reins: emergency and accelerated succession

An effective planning process properly anticipates shorter term and emergency leadership needs. As in long-term succession planning, the CEO's role in planning for these shorter term succession needs is to provide insights about any internal candidates and their readiness to step into the CEO role in an emergency. But once an emergency occurs or when the board concludes that it must quickly make a leadership change, it may no longer be appropriate or prudent for the CEO to have a role in the process.

When there is any hint of a crisis, and thus the risk of eroding investor confidence in the ongoing leadership and performance of the company, the board likely will move quickly to install capable interim leadership, activating the process to identify a permanent successor if need be.

One interesting trend we have noted in the past year or so is for boards that are thrust suddenly into an unplanned succession scenario to appoint an interim CEO. There are clearly benefits to this approach. Such an individual — perhaps a respected director with CEO experience or even the former CEO — may be identified and designated by the board as part of its own planning, just in case a situation arises where the board needs an immediate CEO replacement. With the company in capable, if temporary, hands should a crisis occur, the board then has the luxury of finding a permanent replacement, without rushing to fill the spot and possibly skipping key steps in the recruitment process. Some interim CEOs become permanent CEOs, but that does not have to be the case.

Laying the groundwork for successful succession planning

Regardless of where the company stands on the succession planning spectrum, we believe succession planning works best when:

Succession planning is viewed as a fundamental and ongoing board responsibility closely tied to management development. For companies that do it best, succession planning is not just about selecting the next CEO. It is a comprehensive approach to developing management talent throughout the organization. It is one of a handful of essential duties of the lead or nonexecutive director, but it also is a topic that should remain an ongoing priority for the board and appear regularly on the board's meeting agenda.

There is clarity about the CEO's role versus the board's. It is surely human nature to want to perpetuate the direction you have set, and CEOs are as human as everyone else. CEOs who work well with boards on succession planning are careful not to overstep their bounds — providing their views when needed, but then letting the designated board committee or team do its job. The board's succession planning efforts should be led by a director who is respected both by the CEO and fellow directors, and has the necessary clarity about the CEO's role.

There is a common understanding of the corporate strategy among the board and CEO. It is crucial that directors and the CEO clearly understand the company's direction over the next several years and articulate those priorities and plans in the same way. Understanding the strategy is an important step in helping to define the specifications for the next CEO, who will help to execute that strategy.

There is an ongoing, logical and measurable role for the CEO in the process. The CEO needs to be held accountable for succession objectives that are agreed upon with the board. In accordance with Peter Drucker's long-established maxim, "what gets measured gets managed," leading boards establish measurable annual succession planning objectives for CEOs, as they do with other key CEO responsibilities. At the end of the year, progress against these objectives is measured and reflected in the CEO's incentive compensation. Building specific objectives into the CEO's day-to-day and long-term responsibilities designed to meet these personal goals helps everyone to stay on track.

"In fact, it is when things are going well that both the CEO and the board have the luxury of carrying out succession planning and related management development as it should ideally be done."

CEO succession is now becoming institutionalized at many companies as a far more complex, far-reaching and rigorous process than it was in the past. That more leading companies are anticipating the inevitable departure of the CEO — whether sooner or later, planned or unplanned — and addressing their companies' succession needs should give investors greater confidence. Practiced properly, succession planning also helps to guide the development of management resources and builds the pipeline that leads directly to the corner office. While the board should be charged with the ultimate responsibility for succession planning, CEOs are indispensable to the process. The extra work required to clarify roles and responsibilities of the CEO and the board should be well worth the effort.

About the authors

Jim Citrin, former global practice leader for the Technology, Communications & Media Practice, focuses on senior-level assignments across industries. A regular writer on the topic of leadership, Jim also has co-authored two books on success and leadership with Tom Neff. Tom is chairman of Spencer Stuart in the U.S. and was the founder of the Board Services Practice in the U.S. more than 20 years ago.

The horse race: high-stakes succession planning

John Mitchell, Spencer Stuart — Atlanta

The classic succession "horse race" pits two or three senior executives against each other in a battle over performance — the winner becoming the next chief executive officer.

Some executives and governance observers are uncomfortable with the horse race approach — which we define as an overt competition for the CEO role among several recognized candidates within an established time frame — out of concern about the potential impact that such a high stakes contest may have on an organization. Nevertheless, the horse race undeniably has been successful in helping many admired companies choose their next leader. Horse races at giants such as General Electric, Procter & Gamble, GlaxoSmithKline and Abbott Laboratories have produced a series of exceptional leaders.

Those who favor the horse race say that it is more than an effective method for choosing the most qualified leader from among several skilled executives. It can bring a variety of other benefits to the organization as well. First and foremost, companies employing the horse race signal an expectation that executives and employees will be held accountable for the company's performance. When it is done right, such a system establishes a culture of leadership development in which future stars are spotted early and groomed in a succession of critical roles through which they attain the competencies and seasoning needed to lead a company.

In this environment, proponents say, an overt competition for the top job also can serve as motivation to individuals throughout the organization, who can see a path to more senior roles in the company. Implicit in the horse race is the board's faith in its management, its leadership development processes and the organization's people. Having several strong internal candidates able to vie for a role indicates that the board and top management have been committed to developing high performers through a variety of functional assignments and stretch opportunities and testing them in ever more demanding roles. In fact, some organizations are so effective in developing a pool of strong leaders that even runners-up in a horse race quickly ascend to the top job at other companies. Famous alumni of GE's vaunted management development system, for example, today run organizations such as Boeing and The Nielsen Company.

While detractors of the horse race do not deny that it can be effective in helping determine the best leader for an organization, they say that it also can be disruptive and divisive if not managed well. A contest for CEO that drags on too long can produce feelings of uncertainty throughout the organization about the outcome. This, in turn, can lead people at all levels to retrench and take fewer risks in executing their assignments until the winner is known. It also is certain that time wasted on hallway gossip and handicapping distracts people throughout the business, further hurting job performance. As the competition intensifies, it is not uncommon for managers to take sides for or against particular candidates. This can create silos that discourage critical team work and knowledge sharing.

Depending on how the competition and the final decision are handled, the horse race can have a lingering effect on the organization's ability to fill key management roles. Once a winner is anointed, the company may lose not only the other senior-level executives who were vying for the CEO position, but also strong leaders deeper in the organization who might have aligned themselves with an unsuccessful candidate.

Systematic leadership development approaches, when well executed, produce great leaders without harming business momentum. In these cases, high-performing managers are given the positive message that they will be groomed for the top role, but they also understand that there is room ultimately for one leader of the business at a time. The old AT&T used to boast that its management development program allowed it to have at least five leaders — groomed during years of careful development — ready to step into the CEO's role at a moment's notice. The management development program was put to the test in the early 1980s, when what was then the world's largest corporation was forced into a breakup. The company had enough CEOs to run the new AT&T that was left after the breakup as well as the seven new "Baby Bells."

"Implicit in the horse race is the board's faith in its management, its leadership development processes and the organization's people."

A board considering whether to use a horse race to choose the company's next leader should, first, consider whether the organization is suited to this type of contest and, second, adopt strategies that can help minimize the potential disruptions.

First, the board and current CEO should consider whether the culture and organizational structure are compatible with a horse race. If, for example, the success of your company's strategy depends on internal collaboration and resource sharing, an overt leadership contest among several high-level executives may not be a risk worth taking. Similarly, the board should have a general understanding of the capabilities of the company's senior leadership and decide whether the executive that emerges at the end of the contest will be appropriate for the needs of the organization at that time.

If a horse race is appropriate for the organization, the board and current CEO should decide how public it should be, which depends in part on how comfortable the organization is with competition. When competition is ingrained in the organization, for example, the candidates will know what to expect, and an acknowledged horse race may create less uncertainty and fear of the unknown throughout the company. The board also needs to come to an understanding with the candidates about their responsibility to the company during the evaluation period.

The board and CEO also must carefully monitor the process and be willing to step in and address any people issues that may emerge. Monitoring succession planning is one of the board of director's primary responsibilities. An important part of this effort is making sure the CEO and senior management are keeping the company's "stars" aligned with the business and its objectives during and following a decision on a new CEO. Careful interviewing of valued executives — perhaps through an assessment project ordered by the board — can help to identify the sorts of developmental opportunities that would most benefit them and demonstrate that they are important members of the management team. The board should ensure that these leaders understand that there are plenty of opportunities for them within the business.

Many directors — sensitive about the increasing scrutiny of company and board performance — are intensely fearful that a protracted succession horse race will lead to a loss of business momentum. They strive mightily to limit the length of the contest. Companies that are most successful with the horse race approach cultivate a culture in which people embrace competition for the top job and the notion that the best leader will emerge from the process.

"Regardless of your organization's comfort with this approach, it is important to recognize that the horse race itself is not the start of a robust succession process, but the culmination of one."

Finally, once chosen, it is important that the new leader quickly reach out to executives who lost the race as well as key individuals on their teams. This may mean offering new roles to some executives, providing additional financial incentives for staying or simply letting them know they are important to achieving the new CEO's vision for the company. For example, the newly named CEO of one international pharmaceutical company quickly called his two rivals for the position to reinforce their importance to the company's future and encourage them to stay. In another example, the new leader of a global food and beverage company expanded management roles for his rivals and consulted with them on major strategic issues.

Taking the long view

Regardless of your organization's comfort with this approach, it is important to recognize that the horse race itself is not the start of a robust succession process, but the culmination of one. The companies that excel at producing the best leaders — whether or not they ultimately rely on a horse race contest to choose their leaders — create a succession culture that has the processes in place to promote the ongoing development of promising executives. These organizations adopt many of the following practices.

- **Systematically prepare high achievers for more demanding roles.**
- **Align the skill-sets of the next CEO with the vision for the company's future.**
- **Benchmark frontrunners against external talent to ensure candidates meet best-in-class standards.**
- **Get to know the candidates.**
- **Plan for an emergency.**

Conclusion

A succession horse race can be an effective tool for assessing top talent for the CEO's role, but it also can be highly disruptive when executed poorly. More important than whether an organization relies on a horse race to identify its next chief executive is whether the organization is effectively developing the senior-level leaders it needs for the future. The board of directors can help the company prepare for near-term and future leadership needs by requiring the CEO and senior leadership team to establish succession processes that prepare high achievers for ever more challenging roles. Experts say today's boards should monitor senior managements' handiwork to ensure proper execution of what is the single most critical of business processes — the care and development of talent and retention of these future leaders.

About the authors

John Mitchell leads the Life Sciences Practice for North and South America, focusing on senior-level assignments.

Shoemaker's child? succession planning for the board

Julie Hembrock Daum, Spencer Stuart — New York
Henri de Pitray, Spencer Stuart — Paris
Carolyn Eadie, Spencer Stuart — London

With corporate boards occupied with responsibilities such as regulatory compliance, risk assessment and executive compensation and succession planning, board succession has something in common with the shoemaker's barefoot children from the old proverb; just as the shoemaker never quite has the time to make shoes for his children, boards — with so much on their plates today — do not devote the time they would like to planning for director succession.

Historically, boards had allowed the chief executive officer to take the lead in filling board seats or tended to replace a retiring director with an individual "who looks like the person who left." Today, of course, boards no longer cede responsibility for director recruitment and succession planning to the CEO, yet they typically address director succession only on an as-needed basis — that is, when facing an impending vacancy.

This approach, however, may put boards at a disadvantage in this time when growth and innovation are top priorities for most organizations. Facing new global and competitive challenges, companies are transforming themselves through new product strategies, different product mixes and expansion into new markets and geographies. In an ideal world, outside directors with relevant experience can serve as valuable advisers to the board and management about the company's market, geographic and product directions and serve as a sounding board for management on the critical issues the company is likely to encounter. Wise boards will want to foresee where the company is headed in the future and have individuals on the board with the expertise to help the company move in that direction as efficiently as possible. Boards can accomplish this by vigorously managing director succession.

A more pressing reason for being proactive in board succession is the acute scarcity of experienced and available board directors. The increased time commitment and perceived financial and reputational risks related to board service have caused many experienced directors to scale back their participation in outside boards. In particular, CEOs — among the most highly valued director candidates because of their general management experience, big-picture view and knowledge of current business challenges — have been curtailing their outside board commitments. Most CEOs simply do not have the time to serve on more than one outside board and, increasingly, boards are limiting CEOs' outside board memberships.

As director candidate "short" lists get shorter, boards that plan for director departures will be better positioned to recruit directors with the desired experience, while boards that wait could deprive the company of a valuable board resource.

External forces, too, encourage a more proactive stance on board succession planning. Investors have become a potent voice in board governance, holding directors accountable for company performance and even challenging the nominations of directors. Institutional investors, on the whole, are looking for board directors who are independent from management and possess the relevant business and financial experience.

In the United Kingdom and Europe, boards have an additional regulatory impetus for actively managing board succession. For example, governance requirements such as those limiting director terms help to promote the orderly turnover of directors and provide boards with opportunities to review their composition and bring on valuable new expertise. According to governance guidelines in the United Kingdom and Italy, a director's independence generally is considered compromised if he or she has served for more than nine years from the date of first election. In France, a director is not considered independent after 12 years (three terms) on the board. Further, U.K. governance rules directly address board composition in the recommendation that the nominations committee evaluate the balance of skills, knowledge and experience on the board, make recommendations on the appropriate board composition and prepare a specification for each director appointment.

"As director candidate 'short' lists get shorter, boards that plan for director departures will be better positioned to recruit directors with the desired experience, while boards that wait could deprive the company of a valuable board resource."

With all of these forces aligned in support of rigorous board succession planning, why aren't boards more proactive in this area? Boards, of course, recognize director succession as one of their key roles, yet they do not always use the opportunity of a vacancy on the board to add critical new skills and perspectives. Why is this and what can boards do to ensure board succession planning becomes a priority?

Reluctance to have the difficult conversations. Human nature being what it is, some boards can find it difficult to discuss more directly the delicate issue of the need to make changes to the composition of the board or whether additional expertise is required. Directors may be reluctant to identify the desired criteria for the board and compare them to the expertise of the current board for fear of embarrassing those board members who do not meet those criteria. While such issues can be challenging for directors, strong boards address them anyway.

Perceived lack of time and lack of process. Because director succession seems like a need for the distant future, near-term business issues take priority for boards. While most boards do have processes for anticipating upcoming vacancies, many do not use this time to evaluate the skills required on the board to support the company's strategy.

"Director departures or retirements create important and rare openings that allow the board to expand or strengthen its skills in certain areas."

Practical constraints. While less of an issue today than in the immediate aftermath of the wave of governance reform, some boards' recruiting efforts place priority on identifying the finance expert for the audit committee. Boards can acquire individuals with this specialized expertise, while also recruiting individuals with the deep industry or business experience in the areas in which the company is moving.

Taking a more proactive approach to board succession

In general, boards tend to be very stable organizations, with little change in membership from year to year. While this stability is valuable, too little change can limit the board's ability to provide effective guidance to management when the organization is headed in a new direction, entering new businesses or exploring new geographies.

Director departures or retirements create important and rare openings that allow the board to expand or strengthen its skills in certain areas. Boards benefit when they take advantage of this natural attrition to recruit directors who can add valuable perspectives about the company's strategy — helping to prepare boards to rise to the new challenges and opportunities the organization will face.

A board can position itself to recruit directors with the desired experience by regularly reviewing its composition. A natural platform for the full board to review its composition and discuss the expertise that it will need in the future is the annual board self-evaluation. Through the evaluation, individual directors and the board as a whole can identify the areas of knowledge the board should possess in the coming years based on the company's strategic direction and the competitive landscape. From there, the board can evaluate whether it currently includes individuals with the relevant backgrounds and, if not, what skills or experience would be valuable to seek in new directors when vacancies occur.

As a starting point, the board should stay up-to-date on the timing of anticipated vacancies, including those due to term limits and directors' plans for retirement, and the needs of individual committees for specific expertise. In many cases, director departures are well known in advance, giving the board the opportunity to plan for specific board openings. While in the past, boards might begin the search for a new board member about six months before directors' elections at the company's annual meeting, the scarcity of experienced and available directors calls for boards to take a longer view. Today, wise boards start planning for vacancies at least 12 months in advance — and in some regions as much as 18 months in advance — reviewing and confirming the desired expertise and qualifications for new directors, identifying potential director candidates and communicating the board's interest well in advance.

"Particularly in the case of CEOs, who often are inundated with board invitations, it is valuable to understand their restrictions and preferences for outside board service, as well as their retirement plans."

It may be helpful to tap external resources at this point. For example, through their work with boards and top executives, search consultants often know on a confidential basis the plans of many senior leaders. Particularly in the case of CEOs, who often are inundated with board invitations, it is valuable to understand their restrictions and preferences for outside board service, as well as their retirement plans. A search firm often has the ability to discreetly test an executive's interest in a new board role and his or her future availability.

Boards are likely to find that regular discussions about board composition and the skills-sets the board should be building for the future will help to create an atmosphere where the topic is less taboo. Treating board succession as one of the board's regular responsibilities may help to create an atmosphere where directors themselves recognize when it may be time for them to leave to make room for individuals with much-needed experience.

Forward-looking boards will elevate the task of planning for director succession. They will engage in an ongoing review of the board's skill-sets relative to the company's strategy and direction and use director departures as opportunities to acquire the necessary capabilities and experience. As they become more proactive in this area, boards will ensure the board as a whole and directors individually have the energy, expertise and experience to guide the organization as it addresses new challenges and market opportunities.

About the authors

Julie Hembrock Daum is the practice leader for the North American Board Services Practice. Henri de Pitray co-leads the Board Services Practice for Europe. Carolyn Eadie is a member of the Board Services Practice in Europe and co-led the global Financial Officer Practice.

Planning your own exit

Carlo Corsi, Spencer Stuart — Rome
John Mumm, Spencer Stuart — Sydney

Today's CEOs, including those who have reached what would in previous generations have been considered proper retirement age, are defying F. Scott Fitzgerald's famous pronouncement about there being "no second acts." Experienced, accomplished CEOs are in greater demand than ever before by a wide range of enterprises, and may therefore have many appealing options open to them, if they are interested in pursuing them.

It is an issue many CEOs wrestle with: how to do the right thing for one's company, while also doing right by oneself. When it is time to move on, how can a CEO manage his or her transition to the next phase of life in the most responsible way with the least negative impact on the company?

Methodical planning is nothing new to experienced CEOs, and they should settle for nothing less when it comes to planning for themselves and their future. We recommend a personal "360" as the best place to start before embarking on a new life phase. This exercise begins with some serious self-reflection: What am I passionate about? What do I still want to accomplish? In addition, it may be helpful to get an honest assessment of yourself from a range of those close to you, including friends and business colleagues as well as your spouse. What do they view as your strengths, weaknesses and perhaps untapped skills or talents that you may not even have thought about building on? You may be surprised at what you learn. Keep in mind the need for discretion when exploring any personal next steps, or even a hint of moving on, with current board members and business associates. We offer more specific suggestions below on how to deal appropriately with the delicate matter of sharing your plans with your own board.

Once you have digested the input from your self-assessment and the added input of those who know you best, consider brainstorming — alone and with others — to generate a working list of options for yourself. While certain choices, such as Olympic athlete or astronaut may be foreclosed at this point, aim to be as expansive and inclusive as possible in generating a working list; it always can be whittled down later. In our experience, CEOs tend to underestimate the range of options open to them, looking at only the most obvious extensions of what they already have done.

When in exploration mode, sometimes your network of key advisers may surprise you with interesting, less apparent opportunities. When your contacts know of your interest, they may be able to "hold" a spot for you or create an opening that fits your time frame. Former CEOs are frequently in demand for a variety of positions, including independent directors, government and community leadership roles, and board or senior executive roles with high-profile nonprofit groups. Another area where we see increasing demand for CEOs is private equity, which taps retired executives for partner roles, operating positions in portfolio companies and as deal advisers.

When you have honed your list to real possibilities that would interest you, you will want to spend considerable time building your bridging strategy. Your bridging strategy might include steps for gaining specific experience important to your next phase or developing helpful personal connections.

Common examples of "paving the way" include CEOs taking an external board position with another corporation, or perhaps becoming involved with government committees or projects and charitable bodies in the final years preceding their planned retirement date. While your bridging strategy should be consciously proactive, it also is built with time and patience. Most worthwhile opportunities do not develop overnight, as you know from your own business experience. Be prepared to work at your personal plan, and regularly and discreetly follow up with those who may be able to open doors for you, just as you would in your role as CEO. The net result of all this activity should be a realistic, desirable choice — or choices — as well as a strategy for nurturing one or more of them to fruition.

"Be prepared to work at your personal plan, and regularly and discreetly follow up with those who may be able to open doors for you, just as you would in your role as CEO."

One important note: Especially if you are an older CEO, do not underestimate lifestyle considerations when you are evaluating and pursuing your next move. New paths, including nonprofits and board appointments, can be far more demanding than many experienced CEOs anticipate. Any potential move should be properly evaluated and vetted. Activities you were able to take in stride over the years as requisites for performing your job and advancing in your career may be unacceptable hardships for you now. If you value quality time with your family or the freedom to travel, for example, be sure to factor them into the equation and make your choices accordingly. This takes on special significance at a time when multinational companies are increasingly interested in appointing boards with global representation, which can be a positive or negative to different people.

The better prepared you are personally for your "next career," the more likely you will effectively manage the notification of your departure with your board and chairman. The ideal is to provide appropriate time for your board to facilitate effective CEO succession and for you to assist the chairman and board in this process. Precisely what the period of notice should be may vary widely, depending on how well prepared you and your board are in terms of ready succession contenders. If internal succession is available and likely, nine to 12 months' notice typically would be sufficient. If external candidates will be required, a minimum of 12 months' notice should be provided to ensure a proper and smooth succession process. Notification to your board typically begins with an informal discussion, leading to formal notice at an appropriate time, which generally is spelled out in employment contracts, long-term incentive plans and the like.

Principles for accomplishing a graceful exit

While everyone's individual exit plan will be uniquely his or her own, here are several basic principles that can be applied to all:

Enlist your personal board. Your own group of advisers and friends — those who know you best — will be helpful as a sounding board and as a source of ideas. Make sure to keep them apprised of your plans.

Invest the time and discipline. Chances are, you have planned carefully for most of your life. The next phase of your life should be approached in the same thoughtful fashion, even if it is the fulfillment of a personal or nonbusiness dream. Step back and take the long-term view, and weigh the pros and cons of your next move to give it the best chance of success.

"The right opportunity may emerge quickly or it may take some time to take shape."

Conduct careful due diligence. Next steps that are not carefully planned and vetted can be personally disappointing and professionally embarrassing, and if you are a large company CEO, it is sure to make news. Be sure to explore positives as well as potential pitfalls of the new opportunities that present themselves.

Allow possibilities to percolate. The right opportunity may emerge quickly or it may take some time to take shape. Try not to adhere to too strict a timetable: discuss your interests with those in your network, and then give the possibilities a chance to germinate. On the other hand, there is also a chance that someone might create an opportunity or adjust the timing if they learn of your availability.

Guard your reputation. Successful CEOs want to launch their personal plans confident that they are leaving the company in steady hands. However, it is not unheard of for an attractive opportunity to emerge sooner than expected. When weighing your personal goals against the needs of the company, our advice is to err on doing the right thing for the company. You have built and burnished your reputation over the course of a lifetime, and you never want to put it at risk.

Leave room for serendipity. Not to suggest that you ignore prudent planning, but remember, some of the best opportunities in life come out of the blue — if you are open to them. How you met your wife or husband, your best friend or got a great job, may be examples. Even as you carefully plan your next move, periodically look in new places for potentially gratifying opportunities that may have escaped your notice.

With their experience and skills in greater demand than ever, and with people living longer, more productive lives, CEOs have the opportunity to reinvent themselves as never before. A combination of careful planning with your own board, and some soul searching and a personal strategy, as we recommend here, can yield a fulfilling second act, or even a third or fourth.

About the authors

Carlo Corsi is chairman of Spencer Stuart in Italy. John Mumm leads the firm's Australian business.

Spencer Stuart advises clients on senior leadership matters, including succession planning and management assessments, and helps recruit effective executives across functions and industries through our dedicated practices.

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