A blueprint for CEO succession

CEO succession is inherently difficult. Very few boards excel at it, yet investors and other stakeholders expect the board to have full command of the process.

A seamless process is desirable but is not in itself a measure of success; boards can easily focus on process to the detriment of its principal purpose, which is to secure the very best available candidate. Indeed, the best indicator of a well-planned and properly executed succession is the impact that the CEO has on the business over time.

This article examines the 10 key steps that a board must take to maximise its chances of appointing the right leader and thereby create long-term value for the company.

The 10 steps of CEO succession

1. Establish strong succession governance
2. Start planning early
3. Define what you're looking for
4. Create a pipeline of internal and external talent
5. Take control of communication
6. Address compensation early
7. Rigorous assessment helps select the right CEO
8. Manage the transition
9. Decide your appetite for risk
10. Don't sit back: the job is not done

Establish strong succession governance

1

Appointing a CEO is perhaps the most critical decision a chairman and board will ever make. Shareholders and stakeholders rightly expect the board to have full command of the process of CEO succession governance.

The first step towards ensuring that all board directors buy in to the process is the appointment of a nominations committee and its chair. Care should be taken not to devolve this responsibility to one individual, out of concern for confidentiality; nor should responsibility be handed to an unrepresentative group of non-executive directors.

Directors who are not part of the nominations committee should be kept abreast of the process and of the candidate list as it develops. Failure to handle this effectively can lead to a fractured board just as key decisions about candidates are being taken. This can cause delay and frustration and, potentially, lead to the wrong candidate being appointed.

However well planned or accepted a CEO change is, emotions will inevitably run high. Typically, the incumbent CEO will look to be more involved than is appropriate. Ordinarily, he or she should play no part in decisions surrounding their succession. It is the responsibility of the chairman to mediate between the CEO and the nominations committee and to navigate the relationship dynamics within the nominations committee itself.

Start planning early

2

Many chairmen are surprised to learn that CEO succession should start as soon as a new chief executive or chairman is appointed. This holds true even if it is several years in advance of an expected change of CEO.

The main reason for this is that identifying and developing potential internal CEO successors is exceptionally time-consuming. There are no short cuts. Assessment of potential candidates' capabilities must be rigorous and, where needed, a structured plan should be put in place to address any deficiencies. If necessary, candidates should be given the opportunity to gain additional experience through a change of role. This can produce a number of high-quality — and highly motivated — internal candidates who are CEO-ready. Dealing with the disappointment of unsuccessful candidates is, of course, a different challenge and one that must be taken very seriously.

It is also essential not to undermine the incumbent CEO. For example, covert research commissioned by a chairman to identify possible external CEO candidates is fraught with risk and deeply unsettling to any mid-term CEO who learns of it. In this situation, the incumbent will want to know "why now?".

But since it is the duty of the chairman and board to plan for the unexpected, they can be open about succession at the time of the CEO appointment and about the need to have a 'back-pocket list' — not least in case of an emergency or an unexpected departure. It should, therefore, be a month-one task for any new chairman to commission some discreet external mapping of potential candidates. Properly done, such mapping looks at 'ready-now' CEO candidates as well as those who may become qualified during the likely tenure of the incumbent.

Define what you're looking for

Before discussing the "who", the board must agree on what the next leader should look like on the basis of the company's desired future position in the market. It is tempting to take the experience, capability or style of a successful incumbent CEO as a benchmark for his or her successor. No sector or company is static, so it is unlikely that a business will want more of the same from its new leader.

Our experience is that before discussing potential candidates, it is vital that the board, having determined the current strategic position of the company, should outline its collective vision and strategy and define the culture that will best achieve its core objectives. Only then can the board identify the optimal capabilities of a potential CEO that will align with the company's strategic direction.

Such unity of approach is invaluable — all too often, unseen political dynamics and competing agendas can derail a board's thinking. This can happen regardless of how seamless the succession process appears to be. Our experience is that investing time up front in the capability definition is a critical component of success.

Create a pipeline of internal and external talent

Much has been written about the merits of internal versus external CEO hires and there are risks and benefits associated with both.

Talent can be internally developed and externally sourced. CEO succession processes will run more smoothly when internal candidates participate. That this approach also encourages the retention of executives further down the organisation is of significant value.

Often, when faced with a sudden CEO change, boards hurry to assess internal talent, seeking to maintain continuity through an expeditious internal solution. However, thrusting an unprepared executive into a highly competitive process can foster a lack of trust and result in a poor decision. By contrast, where companies are committed to building a talent pipeline in which regular development discussions and reviews take place, the results can be very different.

Identifying external candidates is also critical to setting any CEO appointment in context. That's why it is important to assess realistic candidate availability and affordability as early as possible and for this to be revisited on a regular basis.

Take control of communication

Few CEO succession processes are conducted willingly in the public arena, since confidentiality is imperative. However, too often there is no detailed communication strategy.

A chairman should assume control by having a communication plan in place long before any formal succession process begins. The plan will consider matters such as who needs to know versus who needs to be involved; whether or when shareholders should be informed or consulted; and whether the discussion should be open to all non-executive directors or be confined to the nominations committee.

The plan must also set out at what point to involve advisers and if, and when, to appoint a search firm. The chairman may also decide to put in place a contingency to deal with a leak or breach of confidentiality. Boards cannot control information flows entirely, but trust is vital — a breach can compromise both an incumbent CEO and a prospective candidate, as well as damage the business performance and reputation of those companies involved.

Address compensation early

Compensation is an increasingly complex and sensitive area. Conscious of public reaction, shareholders and remuneration committees are seeking greater clarity in CEO rewards. Our experience is that compensation is frequently addressed too late in the CEO succession process, particularly when external talent is involved. This can prove an insurmountable obstacle.

Remuneration policies at UK quoted companies are well established and institutional investors increasingly scrutinise executive directors' pay.

Beware failing to assess at an early stage the inflight awards required by an incoming CEO in lieu of foregone and potential rewards. Where candidates are required to sacrifice existing rewards, one solution is to put an indicative offer before the end of the selection process to help them decide whether or not to remain in the process. In such circumstances, if a candidate chooses to continue and an offer is made, the delay between offer and acceptance is shortened at the time when leaks to the market are most likely to occur.

Rigorous assessment helps select the right CEO

The consequences of a poor decision are far-reaching and long-lasting, which is why CEO selection must be based upon a thorough, in-depth assessment of each candidate. Too often, boards focus on identifying the candidate's experience that they believe is analogous to the direction in which they see the company going. Instead, they should be getting under the bonnet to look at the candidate's core capabilities.

There are too many examples of highly successful CEOs joining a company from an unrelated sector for there not to be an innate CEO capability that can be applied across sectors. When hiring an external CEO it is essential to identify these core leadership characteristics.

An interview setting is not the best place to acquire a thorough understanding of a candidate's personality and cognitive abilities. Many search firms have developed highly effective quantitative assessment techniques that they utilise as part of their candidate assessment. These techniques typically focus on knowledge, skills, competencies, social and emotional intelligence and other personal attributes in order to form a broad picture of each candidate's aptitude and potential.

Manage the transition

Views vary on the merits of a handover from the outgoing to the incoming CEO. Boards typically plan lengthy handovers, believing that this will allow the incomer to be inculcated in the company's existing strategy and plans, and to deliver continuity which is in the best interests of the business.

Continuity can be important, but our experience is that an incoming CEO invariably derives little benefit from a handover of more than a few weeks. Most reflect that a well-structured induction programme devised by the board is more valuable. Where internal candidates are being developed proactively, one might argue that any handover has already taken place subliminally.

Ultimately, each CEO change will introduce a new character and possibly culture to a company. New personality traits, processes and interactions will become the norm. It is important that boards reflect on what they have learned from the process and its outcome in order to add to the institutional knowledge. With board term limits prevalent in most governance structures, many directors overseeing a CEO transition are unlikely to be present for the next one. For those who do remain as directors, capturing those lessons and sharing them with the new directors is an important part of the process.

Appetite for risk

CEO succession is mostly a covert activity and the board is in control of each stage. Every process is different and the emphasis will change, not least based on the company's business situation. What is harder to see, and harder still to predict, is the board's appetite for risk.

The critical nature of a CEO change and the heightened emotions that surround it means that logic can sometimes be lost. Each CEO candidate will need different internal and external support mechanisms, at a time when a unique set of organisational changes may result in the departure of senior executives.

Boards must think through the consequences of hiring individual CEO candidates, mitigate risks where possible and accept the fallout where not.

This is not an undertaking for the fainthearted, but when it is successful the benefits to the company are evident and enduring.

It is interesting to note that in recent years several high-profile CEO changes have turned to external candidates to replace a previously appointed internal candidate where performance has not been as expected.

Each situation is different, of course, but what might seem like a lower-risk, safer hiring option may in fact prove to be higher risk and of higher cost to the company in the long term. Assessing risk and reward is a crucial aspect of a successful CEO succession process and one that the board must address openly and accept.

Don't sit back: the job is not done

The arrival of the new CEO does not mark the end of the CEO succession process. Boards 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. If the situation allows, new CEOs should take their time to review the business-critical changes needed, even though outcomes are not immediately apparent.

The CEO's early performance may also highlight learning issues which should be addressed with guidance from the board. Divorcing these early months of performance from the CEO succession process itself fails to recognise the impact of the board's decision.

Conclusion

The reality is that a board's work in CEO succession is never finished; it is constant, evolving and requires active management. As a new CEO takes up the helm, so the talent pipeline for the next appointment is being developed. Working with a search firm that understands a company's strategic direction and culture as part of the succession planning programme is of significant value to boards.

Expertise in governance and organisational behaviour, applied with rigour and independence, reduces the risk of an erroneous appointment and increases opportunities. When these lessons are put into practice, the investment in CEO succession will pay dividends for years to come.

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