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CEO Succession
Five Steps to Best Practice

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CEO succession is THE number one role of the board.

In today's complex and dynamic environment, investing time and attention to acquire and groom the right bench of talent at the top is a critical priority.

Among the most compelling reasons for companies to more effectively manage executive succession is its impact on shareholder value. According to a recent study by Strategy& of the world's 2,500 largest public companies, companies that poorly execute CEO succession forgo on average US$1.8 billion in shareholder value, compared with those that implement leadership changes through a planned CEO succession process. The study also found that companies in the lowest quartile of performance, measured by total return to shareholders, had characteristics of poor succession processes.

The board owns and is ultimately responsible for managing the process, including defining the profile of the future CEO, collaborating with the incumbent CEO on developing internal candidates, overseeing an external search, making the final decision about the selected CEO, and managing the transition process.

Best Practice

Best practice CEO succession management is designed to answer three fundamental questions, namely:

- What leadership does the organisation need to succeed?
- What leadership does the organisation have in place at present?
- What must happen to close the gap and keep it closed?

> "The main thing companies can do to prepare themselves for CEO succession is to build an ongoing governance discipline that operates as a continuous loop"

Five Stage CEO Succession Process

Johnson has supported some of Australia's leading organisations through CEO succession processes. Over this time, we have developed a five-step process to ensure seamless and high-impact CEO appointments, mitigating the risk of failed succession.

1. Building the CEO Profile

The first question to answer is what type of CEO does the company need to succeed in the future?

Boards should take the time to arrive collectively at the profile of the ideal future CEO.

The criteria chosen should reflect the future aspirations of the company – not the past. The board should begin by examining company direction and strategy over a five year plus horizon. Key questions that the board should ask include:

"What is the desired culture of the company to achieve our strategy?"; "What is tomorrow's strategy going to accentuate?"; and "Where will value be created in the future?"

This clarity regarding criteria is important because it reinforces the reality that no CEO candidate is perfect from the outset. All of the available options (whether internal or external) will have noticeable strengths, weaknesses and areas that they need to develop. The board's challenge is to decide what deficits it can live without (usually because they can be compensated for by the rest of the leadership team), and which two or three criteria are non-negotiable must-haves.

2. Assessment of Candidates

The second question is what leadership does the organisation have in place at present?

Having agreed a set of core competencies in a future CEO, the board should then commit to a process by which potential internal candidates will be objectively and consistently assessed against those criteria. An assessment will be designed to meet the specific needs of the organisation; however the key elements typically include behavioural and competency based interviews, simulations, 360 degree feedback, written submissions and psychometric testing.

Participants should feel they have had a chance to highlight their skills and experience as it is important that they see the process as a constructive, objective and valuable exercise.

In parallel to the assessment of internal candidates, external talent pools should also be explored. This 'External Succession Mapping' ensures that when the time comes, the external search can be accelerated as numerous targets have already been identified, and in some cases, assessed against the CEO selection criteria.

3. Accelerated Development of Internal Participants

All potential future CEOs will have capability gaps and some behavioural deficiencies. These 'devil you know' issues can be addressed successfully in many cases. High-potential future CEOs in our experience are strongly motivated to be the best they can be.

However this takes time – generally years, not months. Executives need to understand their development areas, explore ways of addressing them, practice new approaches and consistently demonstrate improvement. The board also needs to allow time to build confidence that an executive has truly addressed development gaps, which is critical to mitigating risk and building a broad consensus that prior views about an individual no longer apply.

Based on the assessment of internal participants, development plans should be agreed between the internal participants and the CEO. The goal is to close any gaps and to prepare them for CEO readiness. Development initiatives include formal coaching and mentoring, increased board exposure, external education and secondment onto special projects, overseas postings, and cross-functional appointments.

Although the CEO has primary responsibility for developing CEO successors and executive talent, directors should regularly review and advise on the executive development process, get to know and support the development of high-potential individuals and advise the CEO. Collectively, the CEO and board should find opportunities for directors to engage with executives that go beyond the typically heavily scripted situation of having executives present in board meetings. For example, the CEO might ask executives to be on-point in addressing critical issues or opportunities, and then engage selected directors in advising on those issues. They might also arrange lunches, dinners, or other social events to engage outside board meetings.

4. Board Decision

As the board nears its decision to appoint a new CEO, it will need to agree upon the final process for determining the successful candidate. A Nominations Committee is often authorised to agree and lead the process with a recommendation finally made to the full board.

The Nominations Committee will typically run internal and external processes in parallel, namely:

- Internal: Reviewing updated individual candidate assessments against the agreed CEO Profile. These assessments should reflect any progress made by the candidates to close any critical gaps in technical experience and leadership approach
- External: An external search should be conducted to ensure that the very best candidates are considered. External candidates should be assessed against the same CEO Profile as the internal candidates.

Once a long list is settled, all candidates should be ranked against the core competencies and attributes agreed in the CEO Profile. Those that best meet the agreed profile should comprise the short list.

Once a short list of candidates is agreed, the Nominations Committee or full board will typically conduct interviews to reduce the list to a small group of two or three. Those preferred candidates are typically given an opportunity to present to the board. The presentation is useful to understand differences in strategic direction, approaches to leadership, personal motivations and aspirations.

Ultimately, due diligence will be conducted on the preferred two or three candidates including references, background checks, qualification checks, media checks and psychometric testing.

Once the board has chosen the successful candidate, they must carefully manage communications to unsuccessful internal candidates. CEO succession processes often cause unsuccessful internal candidates to consider their opportunities outside the firm. A well run and objective process can reduce the risk of departure of key personnel.

5. On-Boarding the New CEO

A thoughtful, structured on-boarding process is critical in ensuring the most successful induction of the new CEO.

Naturally, each executive and company will have different needs. However, there are a few consistent challenges for successful internal candidates, namely:

- They are generally unproven and consequently need to manage potential scepticism
- They will need to be more organisationally savvy and politically astute
- They will deal with greater internal and external complexity
- Stakeholder management will be key.

An external candidate too will face many challenges – crucially their success hinges on their ability to integrate quickly and to align to the company culture. Therefore, organisational and political savvy are critical competencies for any external candidate.

Conclusion

Critical to the long-term success of all companies is their ability to identify and develop a pipeline of exceptional future leadership. Consequently, the selection of the CEO is the single most important decision that a board can make. Yet, the daily headlines in the press suggest that many get it wrong, which questions the reliability of the processes being used to identify and develop future leaders.

In their 2014 piece for the Stanford Closer Look Series, governance experts from Stanford University and The Miles Group reveal a number of broad misunderstandings about CEO transitions and how ready boards really are for this major change. Key amongst these findings was the notion that in practice, boards are not always adept at evaluating the current CEO or potential successors.

The authors believe that when it comes to CEO succession, boards tend to put considerable weight on financial track records and perceived "leadership qualities" without enough consideration to:

- Why they need to change the CEO in the first place, and specifically what are the capabilities and competencies required in their industry for the future
- What existing leadership can be leveraged, and how to engage and process internal candidates without rocking the boat
- How to reduce existing and future leadership risk.

Poorly defined and executed CEO succession strategy promotes management and operational risk, which comes at a significant cost. It is prudent, therefore, that board's develop a rigorous and thoughtful approach to making one of the most important decisions they can make; the succession of their CEO.

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