PAUL B. SURPRENANT
Director, Human Capital Consulting

The CEO Succession Plan: Owning the Future

Sometimes, boards get lucky. Uber's selection of a new CEO in mid-2017 is a prime example of a good outcome despite near non-existent preparation and a troubling lack of awareness of the digital world in which it is a pioneer. Uber's business platform was built on the power of connection. Its corporate governance and CEO succession management practices were built on playbooks from an earlier era. Well after stories surfaced about toxic workplace behaviour and regulatory malfeasance, the board drew on tried-and-true practices to address the issues – bring in a reputable consultant, conduct leadership and environment reviews, deliver a long-term plan, and obtain pledges to change. It did not work. In this open source era, where social media drives opinion and 'fact', accurately or otherwise, the Board's actions were as out of touch as they were out of date.

Good intentions are no match for social media's speed and power to disrupt. When its CEO, Travis Kalanick, did finally resign, to the call of many and the surprise of few, the board was unprepared. It had no successor lined up. It had no succession plan in place. It was not even able to execute the standard fall back of the unprepared board, which is to appoint the board Chair as the interim CEO. Indeed, the Uber board seemed to have lost the plot, that as long as Uber was growing in value, there was no need to devote serious time and energy to succession.

> When a board simultaneously announces the departure of a CEO and the hiring of an executive search firm to identify a successor, the board is also announcing its failure in succession planning.

In 2015, turnover amongst global CEOs hit a 15-year high.[1] Increasingly sophisticated and demanding shareholders and proxy groups continue to raise the bar for CEO performance and conduct. Armed with analytics and using social media as a weapon, shareholders are pressuring CEOs and boardrooms as never before, demanding better performance and forcing change. Empowered shareholders are not the only challenge. CEOs have an image problem. The 2017 Edelmen Trust Barometer report found just 37% of respondents consider them credible. CEOs today work in a climate of distrust, one in which they are constantly scrutinised and, in this open source era of abundant information and ubiquitous communications, immediately vulnerable, whether fairly or unfairly.

How Boards are Responding: Succession Planning

For the most part, boards are paying attention. They are planning for succession more than ever before. A 2010 Stanford study found just 54% of firms were developing a successor to the CEO, while 39% indicated they had no viable internal candidate to replace their CEO immediately if the need arose.[2] Just five years later, a 2015 study showed happier findings, that planned successions had increased from roughly 50% of all successions in early 2000s to 78% of successions in 2014.[3]

That more boards are planning CEO succession is not surprising. Besides disruption to operations and risk to employee morale, unplanned successions are hugely expensive. **Strategy&** calculated that firms that had undergone an unplanned CEO departure lost on average US$1.8b more in shareholder value than companies that planned their CEO successions.[4] Indeed, investors are twice as likely to sell shares during a CEO transition than buy them [5]

One classic study covering a 17-year period found an inverse relationship between company performance and the time it takes to fill the CEO position when a CEO departs suddenly – the longer it takes, the worse it subsequently performs compared to its peers.[6] And to make the point abundantly clear, the same study found firms that name a successor immediately outperform those that delay naming a permanent successor.

Boards are communicating more about CEO succession today. The market is no longer content to wait until a crisis or the succession event itself. Witness the recent turmoil at India's ICICI Bank and shareholder demands for information about the bank's CEO succession plan and readiness of potential successors.[7] Stakeholders expect and demand transparency about CEO succession plans.

Boards are responding. In 2017, **The Conference Board** found that boards are becoming more communicative about their succession plans, providing more information about their processes and the roles of the board committees and directors.[8]

The Board in CEO Succession Planning

Succession planning is often thought of as a proxy for the quality of a firm's overall governance and of a board's performance. Organisations that do CEO succession well are assumed to be better managed, clear about their strategy, and strong in execution.

The data shows boards are more involved in succession planning than ever before. Indeed, there are positives to be drawn in current trends. Nevertheless, the quality of CEO succession planning remains a worry. To perform it effectively, we have found there are five things boards need to do:

1. Own the succession plan;
2. Future-base the CEO Profile;
3. Build the CEO pipeline;
4. Embed accountability – the board's report card; and
5. Keep the plan relevant.

We describe each below.

1. Own the Succession Plan

Good succession planning is as much about process as it is outcome. It interweaves complex, at times intangible, aspects of the enterprise – strategy, operations, culture, and leadership – into an integrated effort to identify, evaluate, and prepare candidates for the CEO role and guide the CEO transition with as minimal disruption as possible.

While the entire board has a role in the selection of a CEO successor, many boards name a committee to lead the succession management process. This committee, typically headed by the lead independent director, is responsible for developing and executing the succession plan. It, in agreement with the rest of the Board, decides whether it will focus on CEO succession exclusively or if it will extend its purview to developing a pipeline of leaders to fill the CEO role and other key senior positions, in part to build a deep bench of future CEO candidates.

The board owns the succession plan and all its processes, not the CEO or HR. It decides how widely it will communicate the succession plan, and the extent to which it will include the CEO or HR in its considerations. Both the CEO and HR have their roles to play – in feedback on candidates, in input on the future business landscape – which the board needs to define up front.

The CEO succession plan is a written document. At its best, it is strategic framework and living document. As strategic framework, it describes the market, services, and talent context in which the enterprise will operate in the future. Importantly, it links the desired attributes of the future CEO to the long-term strategy and vision of the organisation.

As a living document, it covers the processes, responsibilities, and progress of the succession plan. While every board will have its own priorities, each succession plan should cover:

- Processes and criteria by which CEO candidates will be identified and evaluated;
- Roles and responsibilities of board members, committees, CEO, HR, and any external parties;
- Contingency actions and communications strategy in case of a sudden, unplanned departure of the CEO; and
- Names and current readiness evaluations of CEO candidates and estimates of when they may be ready.

CEO succession planning is clearly sensitive. Discretion is paramount. The board needs to keep individuals' names and evaluations confidential. This is to minimize the chance of talented leaders leaving if they saw the assessments (or if they have even made the list) and to avoid undermining the current CEO. Notwithstanding, the board may want to communicate aspects of the plan, such as attributes and values desired in the next CEO, to provide transparency to leaders with CEO ambition.

Communications during any CEO transition are critical, whether it is planned or forced. The CEO succession plan should devote a section to its communications strategy. The strategy will identify the board's spokesperson during transition, key messaging by stakeholder group, and the channels to be used to communicate the change. It may also include contingency actions, such as temporary assignments of responsibility, to be put in effect during the transition period.

The objective of the communications strategy is to lessen disruption and provide direction. Communications in the case of a CEO's sudden removal, for example, need to be clear, swift, and composed to reassure stakeholders and to protect the firm's value. Convoluted messaging coupled with uncertainty over who speaks on behalf of the board or firm would be a sure path for converting a challenge into a crisis.

2. Future-base the CEO Profile

Too often, when identifying potential CEOs, boards prioritise candidates' histories. And why not? A successful track record is tangible evidence of an individual's ability to leverage the organisation's capabilities to deliver results.

However, a record of past success, as impressive as it may be, is not a good predictor of future performance or, more importantly, a good indicator that an individual's strengths are the right ones for leading the business in the future.

This is not meant to discount current leaders. However, the imperative is to ground CEO succession planning in what is necessary for tomorrow, not what is working today.

To guide the evaluation and decision processes, each board should develop its own CEO Profile. The CEO Profile is an invaluable tool for creating a concise summary of the character, values, expertise, and capabilities needed of the future CEO. It is tied to the organisation's vision and long-term strategy and represents the most current thinking of the board.

When defining the required attributes, boards often do a decent job identifying the business and technical knowledge needed by the next CEO. However, they need to go further. Boards need to be able to identify candidates capable of driving culture, leading through values, building teams, and fostering agile organisations that can innovate and scale.

Getting diverse, opinionated board members to agree on the critical attributes needed by their next CEO is not always straightforward. One unusual, but effective method is for the board to organise its thinking using a set of 'what-if' business scenarios, with each scenario representing a progressively increasing degree of disruption from the long-term strategy. For each scenario, board members identify and rank the critical leadership attributes needed for managing through it successfully. The scenarios should stretch the board – just like they would the business – and require it to balance hard knowledge and soft skills.

Another method is to run 'alt-scenarios.' In 'alt-scenarios', boards look at the firm's industry and market opportunities from radically different perspectives -- the predatory market entrant, the voracious cost cutter, the cashed-up capitalist on a mission, or even the slow-and-steady incrementor. The objective is to broadly consider the competitive landscape the future CEO will be facing and then track back to the attributes he or she will need to lead the firm successfully.

Future-base the CEO Profile

Before Ford hired Alan Mulally in 2006 as its CEO, the board recognised it needed a CEO unlike any it had in the past if it was to make the necessary changes to the business and survive. In addition to the many internal challenges, it assessed the macro-economic forces impacting the auto industry and manufacturing to understand the landscape its next CEO needed to operate in.

The board described the next CEO in its profile: "a CEO-ready leader, world-class in life and career experience, well-grounded in complex manufacturing and operations, and highly conversant in technology and its importance in sophisticated machinery in today's vehicles and those contemplated in the future, including electrics and hybrids that use a combination of electric and internal combustion for power."

It went further -- the next CEO would be confident, passionate, and tireless. He or she would be tough with recalcitrant stakeholders, clear in purpose and communications, and have the mental agility to handle ambiguity and unexpected crises.

3. Build the CEO Pipeline

In 2004, when McDonald's unexpectedly lost two CEOs in the same year, it was able to name permanent successors within hours of each loss. Come fifteen years later, and despite the learnings and improvements, most boards could not do this today. Those that can, share this practice -- they continuously develop and monitor a pipeline of leaders. In so doing, they minimise CEO succession risk while simultaneously building depth and resilience in their leadership team.

To build a healthy leadership pipeline, boards need to source deeply into the organisation. This requires a strong partnership with HR. The committee chair should work with the head of HR to implement robust open source methods that overcome the biases inherent in traditional CEO and top talent nomination processes. HR supports the board in other ways, too. Often with the current CEO, the head of HR provides essential information about candidates' development. He or she also assists the committee chair in ensuring evaluative discussions remain tied to the CEO Profile.

Boards have a multitude of evaluation tools available to them – performance assessments, 360^{o} behavioural reviews, psychometric instruments, qualitative feedback, to name the more common ones. Historically, the challenge has been finding the tools that best measure the attributes they believe important and then striking the right balance between them. In the 21st century, though, with the scale of data publicly available and advances in data science, boards can do better. Human capital analytics offers evidence-based techniques to assess and measure candidate performance and behaviour.

Analytics can provide insights not available through traditional assessment tools. While it cannot, yet, reliably predict future CEO success, it can greatly assist in understanding candidates' potential impact and performance. Just as fintech firms use multi-variate, untraditional data to predict behaviour and measure individuated risk, boards can apply similar techniques to get deeper insight on their candidates.

There is no 'best practice' analytics approach or data set to predict future CEO success. Boards should use metrics that make sense for their business and aligned with their CEO Profile. Analytics-based assessments can be constructed using direct and indirect metrics -- financial and operating performance, performance and competency assessments, brand and employer rankings, environmental and social quality scores, corporate trust rankings, and even network effects, such as number of peers or subordinates hired into executive positions elsewhere.

Allowing for creativity is necessary. One innovative board incorporated an evaluation of changes in types of jobs advertised at a competitor firm from which it was considering poaching a senior leader. It looked at that firm's progression in brand reputation and perceived employer value proposition and correlated it to changes in how it described its purpose and the work it performed. In the 21st century, boards need to be thinking differently, and as creatively as the candidates they need to run their organisations.

4. Embed Accountability – the Board's Report Card

CEO succession planning is ongoing. The committee chair leads the full board in reviewing progress against plan. If the process is not producing a solid list of candidates, the board should consider conducting progress reviews as a standing item on its meeting agenda. If the board is confident its succession plan is in good condition, progress reviews one to two times per year should be sufficient.

Boards understand that adding CEO succession to the meeting agenda as a standing item may set off alarm bells and might send an incorrect message about their confidence in the current CEO. Clearly, communications need to be managed wisely. One good approach is to normalise CEO succession, making it a recurring, routine topic in which rotating aspects of the plan are covered in each meeting.

There are many ways to evaluate progress; however, good assessments cover the essential processes and conclude with the board's qualitative judgment of the health of its succession plan. At a minimum, the board should address:

- CEO profile, verifying it remains a concise, accurate summary of desired expertise, behaviours, and character desired in the future CEO(s). in light of market developments, progress against long term strategy, and nascent business challenges since last review;

- Effectiveness of CEO candidate sourcing and evaluation methods, with the board challenging itself to verify its candidate nomination processes are not biased toward a particular skill set or function and cast a net deep and wide enough into the organisation to identify the best talent; and

- Readiness of candidates, reviewing their key achievements, development, and the breadth and complexity of challenges they address, coupled with observations on the type and quality of interaction board members have had with them.

The report card concludes with a qualitative judgment – the considered opinion of the board whether it is meeting its obligation to identify and evaluate CEO successor candidates and prepare the preferred candidate and organisation for transition, whether it be a sudden or planned one.

5. Keep the Plan Relevant

Having developed a comprehensive succession plan, the board must keep it relevant. The plan should be reviewed at least once per year to ensure that all components—particularly the CEO Profile and assessments of candidates against the profile —are up to date. The development plans of candidates should be based on those assessments, addressing areas where additional knowledge, experience, or organisation savvy are needed.

The board may determine it necessary to add external candidates to the succession plan or even decide an external candidate is preferred over internal ones. To the extent possible, it should apply the same processes in evaluation and monitoring as used for internal candidates.

If the board is considering external candidates or has selected one as the preferred next CEO, it should update the sections in the succession plan document covering communications strategy, key messaging, and contingency actions during CEO transition. The objective is to minimise potential disruption and risks to morale, while quickly providing direction to employees and the market.

CONCLUSION

Firms in all industries are facing fundamental challenges in near every facet of their business. Escalating buyer demands around service, quality, and price are forcing CEOs to rethink their production and customer models. Changing employee perceptions about the nature and value of employment are forcing CEOs to rethink how they organise work, develop and engage staff, and promote behaviours that deliver excellence.

The attributes considered essential for a high-performance workforce have also changed. The latest research shows employers are looking less for employees with technical knowledge than for employees with the ability to work in teams, solve complex problems, prioritise, and engage with a variety of people. Future CEOs will be leading in business models and people environments fundamentally different from the ones in place today.

The cost of short-changing CEO succession planning is high. The data shows this repeatedly. Succession planning requires disciplined board attention, but the benefits are worth it -- in minimising financial, operations, and workforce disruption, and outperforming the competition.

CEO succession planning is grounded in the business' long-term strategy and the board's understanding of the future landscape in which the organisation will operate. Succession planning is a deliberative process. The board defines the leadership attributes the next CEO will need, which it uses as the basis for evaluating candidates. It documents its progress against the plan's objectives and timeline it in its own report card. The plan is a living document. The board conducts full reviews of its approach and processes on an agreed schedule and decides which elements, if any, to update.

Every board has a singular accountability to do CEO succession well. It is the one thing it must get right. CEO succession planning is key to the success of the business and, reciprocally, to the credibility and reputation of the board.

> "One of the things we often miss in succession planning is that it should be gradual and thoughtful, with lots of sharing of information and knowledge and perspective, so that it's almost a non-event when it happens."
>
> Anne M. Mulcahy
> Former Chairperson and CEO
> Xerox Corporation

Footnotes

[1] *"Succession Planning: What the Research Says"*, Harvard Business Review, December 2016

[2] Rock Governance Centre, Stanford University, 2010

[3] *"The $112 Billion CEO Succession Problem", Strategy+Business, Summer 2015*

[4] *"Annual Study of CEOs, Governance, and Success"* Strategy%, 2016

[5] *"CEO Transitions"*, FTI Journal, 2011

[6] Journal of Managerial Issues, Pittsburgh State University, 2013

[7] *"ICICI Bank chairman meets MF heads over succession plan, if Kochhar quits",* Business Standard, 19 April 2018

[8] *"CEO Succession Practices",* The Conference Board, 2017