### Planning a CEO Transition in a Challenging Industry

At the end of 2009, the CEO and board of an industrial company began a long-term succession planning process with the goal of naming a new CEO in 2016 or 2017. The company wanted to focus on an internal successor because its industry had undergone dramatic change, and the company believed the best options were internal candidates. With the active participation of the current CEO and the board, and with the support of the CHRO, the company began a detailed assessment and succession planning process. It developed criteria based on the company's future strategy (and refreshed that criteria as the strategy evolved) to evaluate internal candidates as far as three levels below the CEO. The company rotated those candidates into new roles as part of their individual development plans and conducted iterative assessments of each candidate's progress. As a result, some two years before the potential transition, the board is well prepared.

## Mitigating Risk in CEO Succession Planning

In today's corporate environment, board directors do not need to be reminded about the negative business impact of uncertain continuity in the CEO role. Since the U.S. SEC's clarification of the board's responsibility for CEO succession planning, we have seen that most boards have ensured that a CEO succession process of some type is in place.

However, regulatory guidance was not clear. As such, it has been difficult for a well-intentioned board to understand whether its CEO succession process is viable and established standards and requirements are being met. Because of lingering uncertainty about what to do, almost 40% of executives and directors admitted in a recent survey that they didn't have a single internal CEO candidate who could assume the role. Based on our experience in the six years since the SEC's pronouncement, we have some observations and learnings as to how a board can enact the right CEO succession process.

## Evaluation and Development of Internal Candidates

A best-in-class CEO succession process starts three to five years before the expected transition, with the board formulating a succession plan and developing criteria for evaluating CEO candidates. The criteria should focus on the necessary experiences (skills and past accomplishments) and leadership qualities (inherent traits of leaders) required to implement the company's long-term strategy. For instance, aggressive international expansion may call for a CEO with different strengths than would a strategy of growth through M&A. A critical element is for the board to spend the time early in the process to gain alignment on the specific experiences, skills and leadership qualities desired in the next CEO. Board alignment and prioritization of the qualities needed for the next CEO will focus the effort on those candidates with the greatest potential to move the company forward.

After the board approves the experiential and leadership criteria, the CEO should take the lead in identifying and assessing internal successor candidates. Internal candidates usually are the more desirable choice because of their experience with the company's business, people and culture and because between 30% and 40% of external executive hires fail within three years due to cultural and related factors.

A sophisticated assessment process encompasses in-depth interviews with the candidates and referencing with their peers, subordinates and managers (360˚ referencing). The candidates' business performance data and results are considered as part of the assessment.



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### Thinking Two Steps Ahead at a Fortune 100 Company

The CEO succession planning at one of America's leading healthcare companies has been a model of forward thinking. In 2013, the company's board and current CEO began succession planning using the best-in-class process described here. They will soon announce a new president, who is being groomed for CEO several years out, but the company has other possible successors as well. Moreover, the company is using its development process to identify the next generation of leaders, one of whom may well take the reins from the future CEO. They have identified transformational leaders—highly talented individuals who one day may be CEO. The board is planning two steps ahead, developing additional executives with a long runway in order for the company to be well-prepared for the significant industry changes expected to come in the 2020s.

It also includes rigorous assessment by outside experts of each candidate's experiential and leadership attributes, particularly in light of the company's strategy. Many boards do not fully think through this critical step and fail to translate the strategy into the necessary skills and experiences and ultimately make a suboptimal CEO selection.

Internal candidates also should be assessed against the specific leadership qualities that set successful CEOs apart from other leaders. An assessment team should combine the diverse knowledge and skills of search consultants with industry expertise, management consultants with robust business experience and professional psychologists with a sophisticated understanding of human behavior. This comprehensive team produces deeper, more thorough candidate evaluations and more informed decisions by the board.

Based on these in-depth assessments, individual development plans should be tailored for each internal candidate, with specific recommendations to close experiential and leadership gaps. Each candidate's development should be an iterative process, with the CEO monitoring his or her progress every six months and sharing the results with the board.

Over several years, the internal development process will ideally yield a shortlist of candidates who merit serious consideration as the next CEO. If the company has begun the process early enough, it can conduct a second round of candidate assessments after two years, adjusting individual development plans as necessary. A long time horizon also provides a company the opportunity to bring in external candidates and test them in roles along with the internal candidates.

## CEO Selection and the Transition Process

At this juncture, the board should weigh the risks and benefits of the best internal candidates and evaluate them against the top external talent. External market scans are common when the board wants to benchmark internal candidates against possible external candidates or when the internal candidates have not developed quickly enough for the CEO role. Some boards consider a market scan as part of upholding their fiduciary obligations to ensure they are considering the best CEO candidates. Only external candidates whose qualifications significantly exceed internal candidates should be considered for the CEO role. Based on the results of the market scan, the board can determine whether to go to a full search. If the board launches a full external search in parallel with the internal process, external candidates must be carefully evaluated for cultural fit as well as skills.

The board then will select the best candidate for CEO and prepare for the upcoming transition, including the development of a detailed transition plan. The CEO transition requires a specific, detailed plan as it is a risky time, and such plans will reduce employee and investor uncertainty. The outgoing CEO should share as much knowledge as possible with the incoming CEO. The incoming CEO may need to be advised on unfamiliar aspects of the new role, from communicating with investors and analysts to overseeing functional areas beyond his/her prior areas of expertise. As appropriate, internal candidates who were not chosen should be given honest feedback and insights into their future career opportunities with the company as a retention tool. Finally, the board must have a clear plan for the transition of the outgoing CEO which respects his/her service but allows the new leader to be the full CEO.

## The Board's Ultimate Responsibility

Managing CEO succession is a board's ultimate responsibility. A forward-thinking, disciplined process around CEO selection and transition can maintain a company's momentum and significantly reduce the many risks associated with a change in company leadership.

## Eight Key Lessons for Boards in CEO Succession Planning and Transition

**1 Have Courage**

A board must have the courage to address CEO succession planning and transition issues head on, even if there is resistance from the current CEO. While dealing with succession may be uncomfortable at times, the board's fiduciary duties require that it be ready to name the best possible successor when the time comes.

**2 Maintain Courage to Upgrade the Talent Pool**

When opportunities arise, a board must ensure that the company moves to upgrade its internal talent pool. Strong internal talent needs to be moved to the right developmental positions and "blockers" exited from those roles. The pool must continually be monitored and nurtured with an eye toward CEO succession.

**3 Really Know the Candidates**

A board must get to know the company's internal CEO candidates—their strengths, weaknesses, experience, leadership capacity and character. At its best, this process begins years before the CEO transition. Candidate interviews should be well-planned, with board members assigned specific themes and questions to ask all the candidates.

**4 Manage the Candidate Experience**

The board needs to ensure that internal and external candidates are given a positive, professional experience that they feel is transparent and fair. From the beginning, the process should be one they understand, trust and respect. The board should feel good about the outcome, and the process itself should be used as a retention tool to keep the best talent.

**5 Stay Nimble**

A board should develop and adhere to a disciplined succession process. But if the company is in serious decline or if circumstances necessitate, the board must be ready to accelerate the transition timeline. Elevating the incoming CEO sooner than initially planned may pose certain risks, but it can mean better execution of the company's new strategy and improvement in the chances of a successful turnaround.

**6 Watch for Conflict**

A board cannot assume that every step of a well-planned transition will be smoothly implemented in practice. There may be hidden emotions that result in tension between the CEO, internal candidates and/or various board members. The board must monitor the realities of the situation.

**7 Ensure the Baton Is Passed**

Even with a well-conceived succession plan, the transition can be a difficult process for the outgoing leader. Boards try to soften the impact by retaining the former CEO in a continuing role, but this approach may create confusion and even discord. Transition periods should be short, with six months of overlap being the outside time limit.

**8 Set the New CEO Up for Success**

Transition planning should not end on the CEO's first day on the job. Detailed transition planning and knowledge transfer should begin several months in advance and continue several months into the new CEO's tenure.

### The Need for Speed: Accelerating the Transition Process in a Time of Crisis

A once successful retail company that faces intense new online competitive pressures has been forced to reconsider the pace of its CEO succession process. The long-profitable company had in place a three-year plan that focused on developing several internal candidates. But rapid disruption of the company's brick-and-mortar business has required a major shift in competitive strategy—a greater online presence, smaller stores and more diverse product offerings. The right CEO candidate to implement the strategy has not yet been fully groomed for the role. Under the current CEO, change remains incremental. The board has taken a hands-on approach to preparing the incoming CEO and may well complete the transition process earlier than planned. This move might cause friction with the outgoing CEO and other short-term difficulties but should lead to faster, more nimble execution of the new strategy and a greater chance for the company to regain its competitiveness.

## The Role of a Leadership Assessment Partner

A sophisticated executive search firm can assist the board in reducing risk and protecting shareholder value. The search firm can advise the board on best practices, fiduciary responsibilities, assessment of internal candidates, support in their development and assist with the CEO transition. Importantly, a search firm is uniquely positioned to benchmark a company's internal talent vs. external executive talent in the market. Combined with the assessment, this gives the board additional data and a more complete understanding of its options.

Several key factors set Russell Reynolds Associates apart in CEO succession planning. First, the firm has extensive experience in advising boards and CEOs on assessing and developing internal candidates. Managed poorly, internal assessment processes can result in candidates fearing it is a game of "gotcha." But when the process is framed as a supportive opportunity and conducted in a positive manner, the candidates will buy in. We often tell clients: "While this may or may not become a search process, it certainly should be a retention tool. Invest the time in feedback to enhance retention of internal participants." We build strong working relationships with boards and CEOs by providing them with independent, impartial advice without a bias toward any internal candidate.

Second, our dedicated Board Advisory Services Group has more than a dozen experienced members with diverse skills: search consultants with deep sector knowledge, management consultants with expertise in guiding the succession process and translating strategy into key CEO competencies, lawyers and public company directors with experience in risk management and fiduciary duties, and organizational psychologists with proficiency in assessing candidates' leadership capabilities. We are the only firm to have conducted statistically validated research (based on more than 4,000 executive assessments) on the leadership traits that separate successful CEOs from other senior leaders. Our multi-pronged assessment approach, proprietary research and cultural fit assessment tools enable us to conduct a more exacting and clinical assessment of candidates.

Third, our fee structure places no bias on choosing an external CEO candidate. We never attempt to steer a board toward an external candidate except when the external candidate is much more likely to drive long-term value creation.

Fourth, we have extensive experience working with incoming CEOs and boards to reduce transition-related risk. We bring our clients the insight and understanding we have developed over the years to help ensure a smooth transition.



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