In Touch with the Board

Demystifying CEO Succession: **How to Keep Unspoken Assumptions From Derailing the Process**

Over the last five years, boards have been under increasing pressure—by shareholder activists, regulators and shifting business conditions—to make chief executive officer (CEO) succession more of a priority. But with more organizations now focusing on succession planning, the question becomes not whether or not to follow such a plan but rather how to do it well so that it results in a smooth transition to a CEO who successfully can lead the firm over the long haul.

To accomplish this, boards must move past executing succession fundamentals (see Table 1) to addressing less tangible, more nuanced forces that the succession process can set in motion. For no matter how professionally the succession process is conducted, it also is deeply personal and will stir emotions that affect the behavior of all involved. Understanding potential issues before they arise allows boards to proactively work to demystify the process, making it both more effective and positive.

Table 1: Succession fundamentals

A strong, independent board
Honest communication between the chairman/lead director and the CEO
Established, formal processes in place
The board agenda includes succession planning as an ongoing topic
Clear understanding of the job requirements of the next CEO
Coordinated professional development of internal candidates
External benchmarking to ensure the best choice possible

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Take charge of the succession conversations

The roots of difficult successions often are found early in a new CEO's tenure. Despite the adage that succession planning should begin anew on the incoming CEO's first day, in practice, it usually (and understandably) takes a back seat to the implementation of the new vision for the company. Without a clear structure mandating a regular succession discussion between the chairman or lead director and the CEO, it is easy for one year to slip into the next until the CEO has been in office for half a decade before a meaningful succession discussion takes place. His or her successors, having no idea when or if their time might come, begin to entertain offers to lead other firms. The conversation that the chairman or lead director needs to have with the CEO regarding timing suddenly goes from premature to overdue—and all the more difficult to initiate.

There is no set script for dealing with different succession scenarios; the critical point is for the chairman or lead director to be proactive in anticipating them early on.

The chairman or lead director can prevent this predicament by having a yearly conversation with the CEO, starting on the CEO's first anniversary, to review possibilities regarding a succession timetable. The early conversations will be vague, but having the discussion on a regular annual basis minimizes the emotional baggage when the topic becomes more timely.

Those conversations presuppose that the CEO will have a good internal sense of when to start thinking about handing over the reins. However, boards cannot assume this will be the case and need to be prepared to proactively steer the discussion in that direction if need be. Younger CEOs, for example, often are reluctant to embrace the idea of preparing the company to be run without them. But the reality is that the board of such a company needs to be even more concerned about succession planning, given that a successful younger CEO may well receive an offer to head a larger company. In these cases, lead directors can appeal to the CEO's instinct for planning and control; succession for the younger chief executive is less about some abstract retirement and more about preparation for unforeseen circumstances.

But there also are CEOs well into their 60s who show no desire to step aside, even when there are increasing signs that new leadership is desirable. For them, boards need to understand that the sticking point frequently is an inability to imagine a life beyond the C-suite even though the possibilities—establishing a foundation, joining a private equity fund, entering public service or sitting on multiple boards—may offer a very fulfilling second career. For others, the concerns may be economic. Leaving the CEO role, after all, means relinquishing the corporate jet, the club memberships and the trips to Davos. In these cases, the lead director and the head of human resources need to work together to get the CEO comfortable—if not excited—about the next chapter in his or her trajectory. And the CEO needs to be shown that the perks that will have to be relinquished are symbolic and easily replaced from his or her net worth.

A special economic case occurs when the outgoing CEO will, due to years of vested stock options, remain a sizable shareholder of the firm. Here, the CEO is right to expect the same level of involvement that a large shareholder would have. To address these concerns and establish appropriate access, the chairman or lead director can facilitate conversations with the general counsel, the head of human resources and/or the chief financial officer.

There is no set script for dealing with these scenarios; the critical point is for the chairman or lead director to be proactive in anticipating them early on so such issues do not undermine the firm's succession planning process.

Keep the internal candidate pool fluid

Managing the internal candidate pool is another area that calls for particular attention. As Neville Isdell, former CEO of Coca-Cola, noted in the Russell Reynolds Associates video series, internal candidate pools often start strong but do not always remain so. As the company strategy changes with the business environment and as the organization grows in revenue, complexity and geographic reach, the requirements for the top job must evolve as well; the heir apparent today may not be the right executive when it actually is time to choose a successor. Boards, therefore, need to revisit the requirements for the next CEO detailed in the succession plan every six months and, with the help of the head of human resources, check that list against the competencies, experiences and gaps of the internal candidate pool.

"Identifying candidates and having that pool actually is the easier part. The problem is the name in the envelope and renewing that name… because the type of leader you need is going to change depending on both the internal and external dynamic. And that matching of skill sets, against the real needs of the business, is what is not done particularly well."

—Neville Isdell
Coca-Cola's Former CEO

If that internal pool is found to require expansion, the default response frequently is to hire from outside. While that is one solution, it also is possible that the right successor still is within the company but merely beyond the board's view. For while the board often has firsthand experience with the CEO's direct reports, it typically relies on the CEO's assessment of executives a level or two further down. But this is not enough; as part of its succession due diligence, the board needs to make a point of interacting with these executives as well. Many times, the board can see possibilities and potential here that the CEO, who naturally is focused on his or her direct reports, cannot.

It is a pillar of good succession planning that the assignments of internal candidates be integrated with the succession plan to continually sharpen their competencies and address gaps. But it also should be made clear to potential successors that the position they hold when it is time for the board to make a decision doesn't necessarily determine who will become the new CEO; instead, overall performance and fit with the requirements will be the benchmarks.

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Unsuccessful internal candidates rarely are given the unvarnished constructive criticism they deserve and from which they can benefit.

Plan for a smooth transition

While it is important for the chairman or lead director and the CEO to have frank conversations regarding succession planning, the discussion regarding the issue of timing cannot be so specific that it constitutes a disclosable event. If the succession plan and preparation of internal candidates already is well under way, the CEO may appoint a president who is a clear successor a year or so before the CEO wishes to step down and make that appointment with the explicit approval of the board. By involving the board, the CEO signals intent without becoming a premature lame duck. A public announcement then can be made a month or two before the changeover date.

During the transition period, it will be important to define the future role of the outgoing CEO—an issue for which there are more options than once was the case. Some companies, by keeping the outgoing CEO on for a time as executive chairman, may use the transition as an opportunity to separate the chairman and CEO roles if they have not been divided. But this can cause its own problems, depending on how closely the incoming CEO's vision is in line with that of his or her predecessor, the extent to which the incoming CEO can benefit from a final round of mentoring and the outgoing CEO's expectations. Whatever structure is decided upon, the end result needs to be clearly delineated and have explicit boundaries. CEOs have a shorter honeymoon window than ever; inadvertently building in a structural conflict with the new chairman adds an unnecessary burden to an already challenging time.

Manage the unsuccessful candidates

When the successor finally is named, the decision will be heralded as the beginning of a new chapter for the company. But for those passed over, the moment will be defined in terms of what did not happen—and that the non-event will loom as large for them as the elevation of the successful candidate does for him or her. But remember that the unsuccessful candidates are no less important to the company merely because they did not become CEO; indeed, some may be even more essential than before, particularly if their abilities provide a needed complement to those of the incoming chief.

It is standard best practice to have the unsuccessful candidates informed of the decision of the board by the chairman or lead director, in private and before the public announcement. But sensitive delivery of the news is not sufficient. Being passed over can and should be an opportunity for professional growth. After all, the question of "Do I have what it takes to become CEO?" no longer is hypothetical. But if the answer is "Not here, not now," it should be followed by a frank discussion of why not. Unsuccessful internal candidates rarely are given the unvarnished constructive criticism they deserve and from which they can benefit. Often, the entire exchange is so lacquered with diplomacy that the executive doesn't even bother asking why he or she actually lost out.

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This is a wasted opportunity for both sides, and the board, whether directly, through the chairman/lead director, or indirectly, through the head of human resources or third-party consultants, should encourage an honest dialogue that leads to a revised, recharged professional development plan—even if the end game is for the executive eventually to lead another company. The fact is the board should consider every passed-over contender to be on the radar of other organizations; to some extent, each one remains at the company on borrowed time. The goal thus should be to maximize the value, for both sides, of whatever that time may be by continuing to invest in the executive's development. That commitment can be a powerful force in retaining people who can make sizable contributions to the new CEO's success.

Table 2: Demystifying the process

Hold annual discussion between chairman/lead director and CEO on succession timing.
Anticipate reluctance to step down and address it through education.
Continue to update the internal candidate pool to reflect changing conditions and strategic goals.
Get firsthand knowledge of potential candidates a level or two below the CEO's direct reports.
Be aware that candidates' positions when the decision is made will not necessarily determine who is chosen.
Ensure that the outgoing CEO's role is well-defined.
Give the unsuccessful candidates candid feedback and a recharged professional development plan—even if they end up leading another firm.

In CEO succession, the things not said frequently determine the tenor of the process. By taking charge of these undercurrents (see Table 2), boards can make succession a source of strength and continuity rather than disruption.

Author

Charles A. Tribbett, III, is a managing director at executive search and assessment firm Russell Reynolds Associates, where he co-leads the firm's CEO and Board Services Practice in the Americas.

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Americas

Atlanta
1180 Peachtree St., NE
Suite 2250
Atlanta, GA 30309-3521
United States of America
Tel: +1-404-577-3000

Boston
One Federal Street, 25th Floor
Boston, MA 02110-1007
United States of America
Tel: +1-617-523-1111

Buenos Aires
Buenos Aires Plaza
Manuela Sáenz 323
Seventh Floor, Suites 14 and 15
C1107BPA, Buenos Aires
Argentina
Tel: +54-11-4118-8900

Calgary
Suite 750, Ernst & Young Tower
440-2nd Avenue SW
Calgary, Alberta T2P 5E9
Canada
Tel: +1-403-776-4192

Chicago
155 North Wacker Drive
Suite 4100
Chicago, IL 60606-1732
United States of America
Tel: +1-312-993-9696

Dallas
200 Crescent Court, Suite 1000
Dallas, TX 75201-1834
United States of America
Tel: +1-214-220-2033

Houston
600 Travis Street, Suite 2200
Houston, TX 77002-2910
United States of America
Tel: +1-713-754-5995

Los Angeles
11100 Santa Monica Blvd.
Suite 350
Los Angeles, CA 90025-3384
United States of America
Tel: +1-310-775-8940

Mexico City
Torre Reforma
Paseo de la Reforma
115-1502
Lomas de Chapultepec
11000 México, D.F.
México
Tel: +52-55-5249-5130

Minneapolis/St. Paul
225 South Sixth Street, Suite 2550
Minneapolis, MN 55402-3900
United States of America
Tel: +1-612-332-6966

New York
200 Park Avenue
Suite 2300
New York, NY 10166-0002
United States of America
Tel: +1-212-351-2000

Palo Alto
260 Homer Avenue, Suite 202
Palo Alto, CA 94301-2777
United States of America
Tel: +1-650-233-2400

San Francisco
101 California Street
Suite 2900
San Francisco, CA 94111-5829
United States of America
Tel: +1-415-352-3300

São Paulo
Edifício Eldorado Business Tower
Av. Nações Unidas, 8.501 11°
05425-070 São Paulo
Brazil
Tel: +55-11-3566-2400

Stamford
301 Tresser Boulevard
Suite 1210
Stamford, CT 06901-3250
United States of America
Tel: +1-203-905-3341

Toronto
Scotia Plaza, Suite 3410
40 King Street West
Toronto, ON
M5H 3Y2
Canada
Tel: +1-416-364-3355

Washington, D.C.
1701 Pennsylvania Avenue, NW
Suite 400
Washington, DC 20006-5810
United States of America
Tel: +1-202-654-7800

Asia/Pacific

Beijing
Unit 3422 China World Tower 1
No. 1 Jian Guo Men Wai Avenue
Beijing 100004
China
Tel: +86-10-6535-1188

Hong Kong
Room 1801, Alexandra House
18 Chater Road Central
Hong Kong
China
Tel: +852-2523-9123

Melbourne
Level 51, Rialto Towers
525 Collins Street
Melbourne, VIC 3000
Australia
Tel: +61-3-9603-1300

Mumbai
Unit 9(A), Grand Hyatt Plaza
Santacruz (East)
Mumbai 400 055
India
Tel: +91-22-6733-2222

New Delhi
203, Eros Corporate Tower
Nehru Place
New Delhi 110 019
India
Tel: +91-11-4603-4600

Seoul
16F West Tower
Mirae Asset Centre 1 Building
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
Tel: +82-2-6030-3200

Shanghai
Room 4504, Jin Mao Tower
88 Century Avenue
Pudong, Shanghai 200121
China
Tel: +86-21-6163-0888

Singapore
2 Shenton Way
#08-01 SGX Centre 1
Singapore 068804
Singapore
Tel: +65-6225-1811

Sydney
Level 40 Aurora Place
88 Phillip Street
Sydney NSW 2000
Australia
Tel: +61-2-9258-3100

Tokyo
Izumi Garden Tower 14F
1-6-1 Roppongi
Minato-ku, Tokyo 106-6014
Japan
Tel: +81-3-5114-3700

Europe

Amsterdam
World Trade Center
Tower H, 18th Floor
Zuidplein 148
1077 XV Amsterdam
The Netherlands
Tel: +31-20-305-7630

Barcelona
Edificio Prisma
Avda. Diagonal, 613, 2˚A
08028 Barcelona
Spain
Tel: +34-93-494-9400

Brussels
Boulevard St. Michel 27
B-1040 Brussels
Belgium
Tel: +32-2-743-12-20

Copenhagen
Kongens Nytorv 3
DK-1050 Copenhagen K
Denmark
Tel: +45-33-69-23-20

Frankfurt
OpernTurm
60306 Frankfurt am Main
Germany
Tel: +49-69-75-60-90-0

Hamburg
Stadthausbrücke
1-3/Fleethof
20355 Hamburg
Germany
Tel: +49-40-48-06-61-0

London
Almack House
28 King Street
London SW1Y 6QW
United Kingdom
Tel: +44-20-7839-7788

Madrid
Calle Miguel Angel, 11, 7°
28010 Madrid
Spain
Tel: +34-91-319-7100

Milan
Via Mascheroni, 5
20123 Milan
Italy
Tel: +39-02-430-015-1

Munich
Maximilianstraße 12-14
80539 München
Germany
Tel: +49-89-24-89-81-3

Paris
7, Place Vendôme
75001 Paris
France
Tel: +33-1-49-26-13-00

Stockholm
Hamngatan 27
SE-111 47 Stockholm
Sweden
Tel: +46-8-545-074-40

Warsaw
Belvedere Plaza
ul. Belwederska 23
00-761 Warsaw
Poland
Tel: +48-22-851-68-38

Zürich
Löwenstrasse 28
CH-8001 Zurich
Switzerland
Tel: +41-44-447-30-30