Executive Services

Build a strong team of executives, C-suite leaders, and board directors

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The CEO Churn Ahead: What boards must face NOW about CEO succession planning

A Mass CEO Exodus Is Coming

In one of the most unstable social, political, economic, and health environments the world has ever seen, it seems insane to say that we're in the calm before the storm.

But in the C-suite, that's exactly where we are. Because a mass exodus of CEOs and other C-suite members is coming.

Why? Because it was already happening. And, the pandemic has disrupted markets and industries so dramatically that significant changes in leadership are inevitable. It's just a matter of time.

The Stage Was Already Set

Over the past 25 years, CEO turnover has skyrocketed. Starting with the advance of the digital age and the dot-com bubble, CEO turnover rose 50% between 1995 and 2001, according to a study by Booz Allen Hamilton. And then, it kept rising.

As Challenger, Gray, & Christmas began tracking CEO departures in 2003, they saw numbers steadily climb. In fact, 2019 marked the highest year on record for CEO departures, outpacing turnover even during the depths of the recession in 2008 and 2009.

The rising rates in recent years weren't just caused as retiring Baby Boomers (who held off on retiring during the recession) began to experience investment portfolio gains. Rather, about half of departing CEOs are fired, even if the official public statement reads that they stepped down or left for personal reasons, according to Exechange, a firm which tracks executive turnover. That's a significant increase since 2006, when only about a third of CEO exits were involuntary.

As 2020 began, January saw record CEO departures, setting the tone for an even more disruptive year. But as the pandemic and economic fallout began, CEOs stayed put. CEO departure rates plummeted to the lowest rates in more than a decade. But if the past is prelude, the lull will be temporary.

We're already starting to see numbers rise again in CEO departures. And as companies gain stability in the new normal of 2021, we expect to see an explosion. And it's going to take the C-suite and its bench with it.

Monthly Departures

Source: Challenge, Gray, & Christmas

COVID Will Clear the Bench

The boards who have held off on replacing their CEO during this crisis are likely biding their time until there's increased stability. So the stream of CEO departures planned for early 2020 will happen – just on a delayed timeline.

But the larger wave will likely come from businesses adapting to the "next normal." Market and business model shifts are unfolding with stunning pace. Certainly many of these shifts were overdue. Even so, new business realities have accelerated strategic focus, simplification, e-commerce, digitization, and greater fiscal prudence to name a few.

Even the most successful CEOs may struggle to perform as their organizations morph. Furthermore, the viable bench of CEO hopefuls will change as well. Prospective CEO successors who were likely fits in the recent past may suddenly lack what it takes to reinvent, reshape, or reenergize their organizations. And there will be little forgiveness for senior executives who hold onto past mindsets while competitors innovate, sharpen focus and drive efficiency to capitalize on the moment.

Likewise, opportunity will be plentiful for those that step up to lead their businesses through turbulence. Those leaders will be sought by both their own and other organizations to shape new futures. And unplanned turnover will rise as some senior executives conclude that turnaround cycles and transformation strategies will not yield a timely payday, leading them to question, "Is it worth it to stay? Or is it time to look elsewhere, or even call it quits entirely?"

As the churn of top executives sets in, investors, boards, CEOs, CHROs and business executives will all be asking one question: Who will lead our company next?

How organizations approach and answer that question stands to be one of the defining competitive markers of this moment in history.

Context Is the Key to Success

In our experience, context is the number one reason CEOs fail. After all, most of these people earned their positions by being exceptional executives. For example, it's very common for founder CEOs such as Uber's Travis Kalanick to be exceptional at launching and growing a company, but struggle to create the corporate and cultural rigor needed to grow and expand the company once established.

Outside a company's internal struggles, major financial and socio-political events may abruptly change the business landscape. For example, major worldwide triggers for CEO changes across the board included things like the Enron fraud and elevation of corporate governance; the bursting of the dot.com bubble; 9-11 and the war on terror; the emergence of China and India as world powers; natural disasters like Katrina, Harvey and the Japanese tsunami; the subprime housing crisis, the 2009 global recession, and the European Union vs Brexit vote.

For many organizations these events exposed a lack of preparedness for sudden business change, including the leadership fallout associated with hairpin turns. Each disruptive event re-framed the strategic context for which executives were chosen to lead. It also imperiled the relevance of established succession plans. This was because succession plans (where they exist), are typically based on known leadership requirements. Rarely are they elastic enough to respond to revolutionary shifts that challenge every assumption.

The COVID-19 pandemic will be exactly one of these world-altering context changes. And it will expose the vulnerability of companies without a succession plan in place.

The Surprising Resistance to Succession Planning

"I literally wrote our succession plan on the back of a napkin over a drink with the chairman."

— one CEO shared with us.

Surprisingly, that approach isn't that uncommon, particularly among private companies. In fact, the National Association of Corporate Directors reports that 20 percent of public companies have absolutely no succession plan for their CEO. And nearly one-third of private companies don't have one.

Why? Often, the board members and CEOs would prefer their succession plans to be private and informal. After all, they've been chosen for their positions because of their seasoned executive judgment. They believe they know what's right for the business, and the time and resources required for more formal, rigorous succession planning may be subordinated to other more pressing business concerns. If it weren't for increased shareholder demands for transparency, it's likely the number of companies with no formal plan would rise even further.

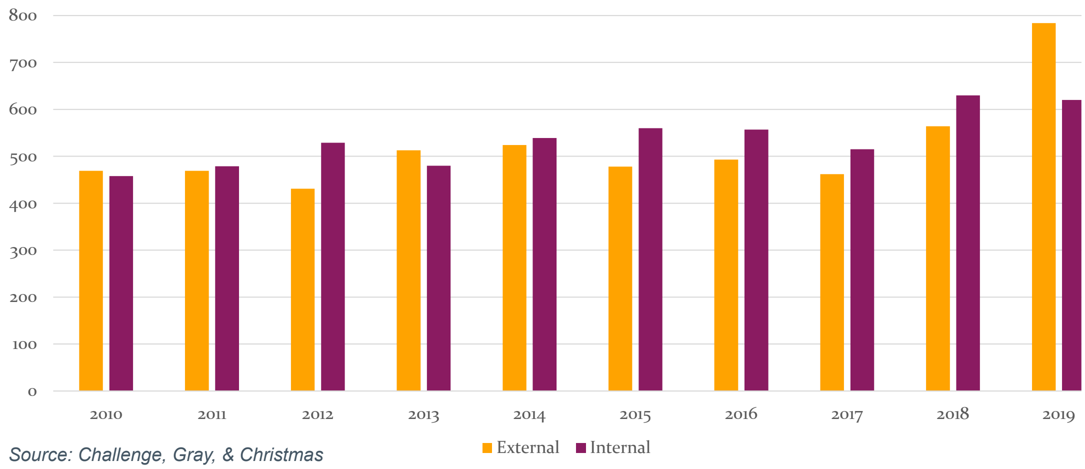
Ironically, more than a few CEOs have shared stories of how they had to urge and educate their boards to prepare for their replacement. Because things were going well currently, the boards were reluctant to make it a priority. According to one of these former CEOs, "it seemed like they really didn't take my interest in retiring seriously!"

It's a surprising vulnerability, given most boards' focus on reducing risk. And it has serious consequences. As more and more CEOs are ousted, companies are forced to look to outside candidates. When decision time arrives, even organizations with designated successor pools face the reality that internal candidates are not ready to assume the CEO mantle.

In fact, in 2019, 56% of companies turned to external replacements for their CEOs. This heightens the risk for a process already laden with uncertainty, as failure rates for external CEO's are far higher than for CEOs successfully grown from within.

Whether boards anticipate CEO succession needs or are scrambling to fill the role after an unexpected departure, few have strong processes in place to vet CEO candidates. Consequently, they resort to traditional or subjective methods for evaluating CEOs—methods that often result in the wrong person being selected. To state the obvious, this leaves their organization vulnerable to future CEO departures.

External Replacements Rising



Source: Challenge, Gray, & Christmas

6 Things Boards Get Wrong About CEO Succession

#1: Allowing Context To Be an Afterthought

Failure to sufficiently consider context is the number one mis-step in CEO succession planning.

In some ways this is understandable as boards strive to preserve stability during transitions from one CEO to the next. This can create a yesterday focused, myopic perspective on what is needed, particularly where a successful CEO has been in place for some time.

In these cases, boards may be tempted to default to a candidate who emulates the best of the incumbent CEO's leadership approach. Other boards adopt a "best athlete" orientation to selection, built on perceptions of what "good" CEOs look like in their industry. Directors are susceptible to confirmatory bias based on past exposure or gut feel about who they want in the role versus *what* will be demanded of the next CEO.

But these approaches undermine the value of an ideal profile aligned to their organization's unique context. It's rare that what made an organization successful in the past will continue to fuel success for the future. So the question isn't whether a candidate is ready to be CEO; it's ready for what? And how in fact, does the next generation CEO need to be different from even the most successful predecessor?

Even the best CEOs are usually far more likely to be successful for one specific context versus another. A CEO who excels in cultural transformation might be an utter failure for a business that needs to expand into global markets. Likewise, the CEOs who excel in cost-cutting eras are likely not the visionary entrepreneurs who will lead a new phase for the company.

Ultimately CEO succession is a scenario planning exercise, in which predicted business context is the primary lens through which CEO candidates should be evaluated. Will future strategies focus on entrepreneurial organic growth through penetration of new markets or product innovation? Does the competitive landscape call for a chief executive who can spearhead market disruption or a cultural pivot, e.g. around digital transformation? Or will the organization benefit most from a CEO whose strengths lend to "double down" on strategies in core markets?

The recent growth economy had, perhaps, created complacency around evaluating candidate fitness to lead through uncertainty and strife. The pandemic offered a reminder that true leadership character will be revealed in unanticipated scenarios, like severe market downturn, a data breach, or public relations crisis.

The paradox of leadership is that some leaders are better equipped to lead in a steady state, where others soar amid challenges and turmoil. These leaders unleash the best in others, encourage self- determination, collaboration and decisive action. And they know when a personal gamble is required for the win.

For example, Abraham Lincoln was a superb wartime president, courageous and stalwart in the face of extraordinary times. Yet most historians doubt he could have been nearly as effective as a "fair weather" President. Churchill is another "war time leader" that stepped up during unique, volatile times.

Boards need to be united in agreeing about their strategic priorities for the future, and make their choices about CEO succession planning within that context. It will take a person with a specific set of leadership skills, personal attributes, and values to be in full alignment with the board's plan for the future. Ignoring those context-specific attributes sets up the CEO and the company for failure.

#2. Favoring Intuition Over Objectivity

One board chair put it to us very simply when evaluating their CEO candidates: *"We know that there are more thorough options for evaluating candidates. Those options are not for us. We prefer a more informal decision-making approach."*

This approach is part of the very long business culture of making decisions based on instinct and experience, rather than objective data. After all, directors are usually brought on because of their experience and sound decision-making. So why should their opinion not be trusted about the next CEO?

It's simple: people are human, subject to their own unconscious biases and blind spots. In fact, that's one of the reasons that there's so little diversity at the top. It's difficult to picture success in a person who doesn't resemble the picture of success in your experiences.

Most boards are working hard to get better at this. But boards are often slow to pursue or embrace objective data to pressure test and differentiate the best CEO candidates. Why?

One reason is that directors may lean into the belief that once leaders have reached the C-suite they are beyond assessment. Candidates are deemed “strong” based on past track record, hallmark accomplishments, or reputation with the board.

Evaluation rigor may also take a back seat when a board is polarized on key decision parameters, such as the wisdom of choosing an internal vs external candidate as their next CEO. For example, we saw this emerge when the board of a global manufacturer dwelled on debate around this tradeoff, rather than seeking a data-based comparison of candidate readiness against an articulated success profile.

In addition, directors can have surprising anxiety over what assessment data might reveal. They worry that a favorite candidate may not perform well. Or they worry that it may challenge their decision-making process if they want to go against the data.

Finally, we can’t ignore the role of hubris. The ability to spot executive potential can be a point of pride for many CEOs and board members. They know the business well, and they may have observed internal candidates during committee collaborations, analyst calls, or informal executive team dinners and events. Likewise, incumbent CEOs also reveal hubris, often favoring an ally or a kindred leader they believe will protect their legacy.

The reality is that the very same personal experiences that may make you think you “know” a candidate may be what creates blind spots. A long or friendly relationship with a candidate can cause you to turn a blind eye to their personal flaws. Meanwhile, a candidate you’ve rarely interacted with may seem unexciting, despite having incredible potential.

#3: Assuming Experience Equals Competence

Boards place a high premium on experience. Probably too high. It’s not surprising, as directors are commonly nominated for their experience-driven insight. We’re not saying experience is unimportant. It is. But experience can be a limiting filter, weeding out those with powerful potential and falsely elevating poor leaders with rich experience.

Directors with deep financial backgrounds will naturally look for commercial acumen. Other directors may be focused on strategy, digitization, markets, and so on. And indeed candidate experience can be an important differentiator. The danger is when the value placed on experience becomes so dominant that it clouds leadership considerations.

So what, exactly, are the skills that boards should be evaluating in CEO candidates? As one CEO put it, *“I’ve worked with these leaders [succession candidates] for years, but I’m still not sure how they’ll handle this job.”* Like an athlete in an amateur league or a performer in a small town, the skills needed to stretch to the top level can be difficult to imagine. Deep insight into how leaders behave in action is essential.

How do they gather, synthesize, and use information to make decisions? How do they behave interpersonally when communicating controversial messages to large groups, or when presented with inflammatory accusations by a media reporter? How do they prepare for and handle analyst calls, or board meetings? What is the dynamic between the leader and his/her team? What might it be like for a senior executive to be coached by him/her? And how do they do all these things when under extreme pressure?

Too often accomplishments are viewed as proxy for these complex CEO leadership skills. Having managed a profitable P&L in Europe doesn’t, by itself, confirm that the candidate has the business acumen to penetrate new markets. Candidate experience may also, at times, be a limiter, diminishing openness to new ideas or challenges around long held convictions.

Even when competence is considered, it is not a given that behaviors demonstrated in earlier roles (e.g. leading teams, business savvy) will transcend into the CEO role with equal impact.

#4: Valuing Knowledge over Personality

Boards of directors are human, and it’s easy for them to miss what they cannot see. As a result, they prioritize what they can see – knowledge – over what they can’t see, personality. But personality, especially in the CEO role, has a tremendous impact on the organization, especially under pressure.

Consider a CEO like Dennis Muilenberg of Boeing. With a background in aerospace engineering and decades of experience at the company, there was never a question about his depth of knowledge to lead Boeing. But where he struggled was under the stress of a crisis following two fatal crashes of the 737 Max.

Muilenberg’s overly optimistic outlook, downplaying of concerns, and desire for a quick fix after the first crash meant the company didn’t ground the plane, leading to a tragic second crash. His continued hopefulness about the timeline to repair the aircraft also eroded the company's relationship with suppliers, buyers, and regulators as the company missed deadline after deadline.

Personal tendencies, such as risk-taking, arrogance, imperceptiveness, etc. significantly affect a CEO's leadership approach. But most people hesitate to speculate about others' personalities, and they often get it wrong. Time and again, boards inaccurately assess how personality will factor into the success, or more often, failure of CEOs. While board members diligently seek industry, organizational and cultural "fit," they routinely mischaracterize the dispositional "fitness" to navigate the CEO role.

Board interviews alone are notoriously unreliable for detecting potential leadership derailers. Nor do they accurately discern positive, differentiating candidate attributes, like resilience or consistency. Interview-savvy candidates may share positives around "bias for action," without dwelling on darker tendencies, like poor listening or missing interpersonal nuance across broader, less familiar constituencies. These tendencies risk creating distance or dysfunction towards those they need most as CEO.

#5: Allowing Politics to Force Compromise

Differing priorities and power dynamics can sow division with boards on how to determine the next CEO. In some cases, the quest for compromise can dilute rigorous, courageous decision making.

These dynamics emerge when board members occupy different strategic camps. For example, some may believe in pursuing aggressive growth through acquisition, while others believe the path forward is conservative growth through operational excellence. Unresolved perspective on the road ahead will, by definition, create differing opinions on the success profile for the future CEO.

In addition, there can be politics about who is a favorite for succession. When different board members are rooting for specific candidates, it can become a game of politics rather than choosing the best possible candidate.

As a result, it can be tempting to compromise. That may mean appeasing the majority of board members who agree on a candidate, or simply accepting that the "heir apparent" will take the CEO position. Other boards try to circumvent these politics by advocating for external candidates.

These outside candidates may seem like "bright and shiny" alternatives, an outside savior who can turn things around. And because external candidates are naturally selective about how they share their track record with the board, boards may gloss over weaknesses that might be known about internal candidates. And they often have credible headhunters aggressively advocating their strengths as well.

When it comes down to it, compromising on candidates to solve board disagreement often ends up meaning that the council settles on the least controversial candidate, rather than the person who will truly be the right fit for the CEO.

#6: Overlooking Culture and Brand

While many CEOs could once stay in the boardroom and out of the limelight, that's rarely the case in today's hyper-transparent environment. The public will not hesitate to demand the termination of a CEO who is known for setting a poor culture or who makes mistakes in the media.

A prime example of this is what happened under the leadership of CEO John Stumpf at Wells Fargo. For more than a century, the bank had a pristine reputation, attracting the favor of industry big-shots like Warren Buffett. But after Stumpf took the helm, there was a major shift in culture that soon led to scandal.

Under Stumpf's leadership, Wells Fargo developed a culture of extreme pressure to sell at any cost. That led to an erosion of ethics to meet sales goals, and some employees felt encouraged to open multiple accounts for customers without their consent. Some even used their own contact information to prevent the customers from finding out.

When the scandal erupted, Stumpf deflected blame to lower-level employees. Eventually, he was fired, and banned from the industry. The bank is still facing billions in legal fees.

The public and shareholders are now demanding that companies put high value on environmental, social, and governance (ESG) issues. Those that fail to do so will suffer in the court of public opinion – as well as in actual courtrooms.

In fact, market analyst and investor guidance are increasingly tied to all important Environmental, Sustainability and Governance (ESG) considerations. Newer valuation priorities include sustainability factors like succession, corporate brand, people, and culture. Yet the importance of CEO as cultural and brand ambassador often still gets short shrift.

Public scrutiny on organizational performance has soared along with the rise of social media and the ethos of social responsibility and sustainability. This heightens requirements for CEO communication, emotional intelligence and ethics, offering both new risk and opportunity to amplify outreach and messages.

Unfortunately, predictions around leadership integrity are at best, inexact. Still boards can seek lead indicators of CEO judgment and credibility under public glare, including personality traits associated with self-management, behavioral consistency, and social confidence.

All of this creates a new pressure on boards to pay attention to what they've often written off as "the soft stuff" when looking at their next CEO candidate. Boards do not have the option to prioritize candidates that achieve bottom line business results at the cost of the culture and brand. Indeed, culture and brand are often now the driving force behind business value.

Five Practices Your Board Needs to Adopt Now

Most boards fall into one or more of the six pitfalls above as they plan for their future. But there are five critical practices that can help you beat the odds:

1. **Declare C-suite succession as a top tier business strategy.**

   Given economic headwinds, business-driven succession processes are more critical than ever for organizational sustainability. C-suite succession planning is a competitive differentiator that can be readily influenced—more controllable than markets or the global economy. Proactive succession practices are fundamental to your leadership supply chain and should managed as aggressively and transparently as other business processes.

   A supply chain perspective assumes an on-going business process that never stops. Some organizations begin consideration of successors shortly after a new CEO is seated. We recommend exploring options at least 3 years before an anticipated transition. This affords time to identify and groom a diverse slate of leaders with varied background and profiles. It also supports focused candidate development and demonstrated growth against future requirements.

2. **Make context a part of scenario planning.**

   Every piece of your succession planning strategy has to answer the question "*Who* is ready for *what*."

   It's essential to play out the context of your future business strategy, and weigh potential successors' strengths against those likely circumstances.

   Consider various strategic directions depending on changing market, financial, operational and R&D investments. As strategies evolve, so should the scenarios against which CEO profile should be evaluated. A turnaround CEO requires a different success profile than a CEO charged with growth through acquisition. Your board should routinely re-evaluate and agree on the top few business drivers that frame the critical competencies, personal attributes, and values you need in your next CEO.

3. **Demand objective and predictive data.**

   CEO selection is a long- term investment decision. It can't be made on gut feeling from the board, nor can it be made based on past performance alone.

   You need data that is both objective and predictive. Structured board interviews capture relevant examples of industry knowledge, experience, and cultural indicators. More rounded methods, especially immersive role simulations, heighten objectivity and predictability because candidates must demonstrate what they are capable of versus relying on claims. Adding in personality measures around enablers, derailment risks and motivation provide a window into what an executive "will do" versus what they know or might do.

4. **Assess the "whole leader."**

   At the CEO level, there's very little room for weakness or failure. Some lack the personal temperament to succeed, while others may struggle more with setting strategy, maintaining key relationships, or creating a culture of ownership. While no CEO will be 100% ideal, it's critical to know that they have the key strengths to be successful in your context. And it's just as important to know where their weaknesses are so that they can work on developing in those areas as well as hiring others on the executive team who can mitigate those weaknesses.

   As a result, your board's due diligence needs to include a well-rounded assessment of the whole leader so you know the full portfolio of assets and risks a potential CEO will bring to your organization. And the board needs to make sure that the assessment data is mapped against what's needed for the specific business context you're facing.

5. **Declare leadership growth to be a board imperative.**

   CEO succession is about far more than a "point in time" decision. It is a vital, dynamic business process designed to ensure leadership capability and continuity. Your board's commitment, time and resources are visible across your organization, consumers and shareholders.

   Defining explicit roles across the board, executive leadership team and CHRO will create broader ownership for success. Board committees, like Compensation or Governance, may take the lead in succession strategy and process.

   As with other core business processes, it is important to clearly articulate your succession strategy with objectives, accountabilities and metrics. This strategy should outline "the how's," including identification and recruitment of high-potential leaders from inside and outside the organization, profiling the CEO role and anticipated challenges, and evaluation of candidates' leadership capabilities. Longer horizon acceleration tactics for targeted leaders toward a CEO and/or C-suite destination will be a game-plan fundamental.

   In today's environment, playing offense around leadership agility and capacity is truly about survival. Without an "all in" board commitment to acceleration, it will be difficult for your organization to sustain the energy and engagement in processes that drive talent growth. There is an alternative: A powerful Board-Management team partnership dedicated to CEO succession. Thoughtfully executed, this investment becomes an enterprise model for cultivating and deploying leaders across the pipeline. In turn, your commitment to leadership growth will fuel your brand story, investor confidence, and competitive viability.

Conclusion

The most dangerous thing for any board to do right now is to think of themselves as the exception, rather than the rule. It's certainly tempting to focus only on the moment at hand, rather than what's ahead.

But no business will escape the pandemic unscathed. For some, it may cause a more radical change than others.

The scale of change makes it inevitable that leadership will shift at the top. And in this newly restricted economy, there won't be much room for boards to make mistakes. NOW is the time to begin creating a data-driven succession strategy that will set up your company for strength for the future.

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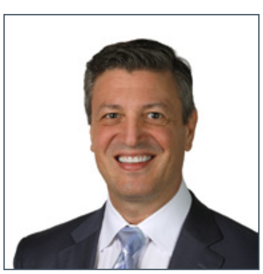

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