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CEO Succession in a Changing World

To paraphrase an ancient saying, no person steps into the same river twice. People must be prepared to adjust to the constant and ever-changing flow of conditions and events. And so it is with CEOs.

Boards of directors have always had to exercise care when managing CEO succession in order to find someone able to navigate change and adversity while also moving the company toward a better future. This mandate has not changed. What has changed is the pace and type of change CEOs are likely to face. Sometimes, the river will be placid, only to become a threatening torrent or to dry up completely when least expected.

In a world where the core challenges of running a successful enterprise continue to evolve, CEOs must possess or have the ability to develop an array of new types of knowledge, capabilities and insight necessary to secure their organizations' futures on behalf of shareholders and other stakeholders.

Finding and developing this type of executive talent has always been an existential challenge for companies. When a new CEO turns out to be the wrong person to lead a company, the fallout can be considerable and it can even happen to otherwise well-run organizations. The Walt Disney Company is just one recent example of a company parting ways with an underperforming CEO after just a few years.

One study found that difficult CEO transitions cost the companies in the S&P 1500 nearly $1 trillion a year, while effective succession planning has the potential add a full percentage point to annual stock market performance and increase company valuations and investor returns by 20% to 25%.[1]

Adding to the CEO succession challenge is a rapidly changing business environment. Pressing issues like environmental stewardship and diversity, equity and inclusion (DEI) require CEOs to focus not only on shareholder value creation but on how the company creates that value. That is why the board of Australian mining firm BHP revamped its CEO succession process and expanded the CEO profile to ensure that candidates are skilled and comfortable in articulating the social value of the enterprise while also implementing policies and metrics and demonstrating leadership in climate, inclusion and diversity, and Indigenous heritage.[2]

Generational change among investors is also driving this expanded CEO mandate. As younger generations build and inherit wealth, they increasingly expect CEOs to weigh the future of the planet while also pushing ahead for greater

DEI. This transition is already underway. A global survey of 400 high net worth families found that about 39% of those under age 40 strongly agree that responsible investing is important to them, while two-thirds of older members of these families say that they are relying on their children for input on these issues.[3]

Finding sustainable CEO talent

Finding and nurturing the executive talent necessary to fulfill this evolving role for the CEO is likely to be a work in progress for some time. Getting it right is both difficult and essential. Almost all boards recognize the importance of CEO succession at some level, with 63% saying CEO succession planning is important or very important and 30% rating it as slightly or moderately important.[4] However, those boards have not necessarily adapted the CEO succession process to mesh with the new requirements for and demands on CEOs.

While the new CEO requirements are still coming into focus, boards must recognize that they may not be able to find CEO candidates internally or externally who are strong in all areas. For example, CEOs will need a new toolkit of skills and abilities that includes softer qualities, particularly the ability to think creatively and identify ways to mesh corporate needs, goals and priorities with those of broader society.

Companies will need these leaders to have the courage and conviction to push back on pressure to maintain the status quo. New CEOs will have to create a clear vision for the organization and what it stands for, while also considering whether to pursue strategic partnerships to achieve certain goals. At the same time, CEOs will need to identify which areas will have the biggest impact for the company, how to use leverage these goals to distinguish the organization from competitors and the risks, opportunities and costs of doing so.

For example, concerns about potential supply chain disruptions cause by political unrest, climate change and other pressures are causing some companies to assess how they manage these relationships and the potential repetitional damage if something goes wrong. Addressing this may require operational innovation designed to diversify supply chains and monitor them several levels down to make sure that the environmental and human rights record of all supply chain partners meets company standards.[5] In this case, new CEOs need to focus on measurable outcomes linked to overall corporate goals and metrics. And they need to know they have the mandate to accomplish and improve performance against those goals and metrics.

For their part, boards of directors must recognize these needs and challenges, take stock of the current state of executive talent in their organizations and adapt as needed. As it stands, the succession planning process in many companies cannot support these new requirements. In fact, many companies may find that no single person on their roster of executive talent has all of these strengths, along with the usual executive attributes and the experience of having managed an organization through both good and difficult times.

If the board is unable to find a clearly qualified candidate, it must be willing to regroup and, if necessary, restart the succession process. After interviewing three promising internal candidates, one financial services firm ultimately found each of them wanting in one way or another and began to consider other internal candidates that had even less relevant experience than the original candidates. Of course, this is not the best way to choose a leader of multi-billion-dollar business. A better approach would be to restart the process, create a tighter focus on what the company needed and wanted from a new CEO and reinterview the strongest internal candidates while also spreading a wider net for talent.

Developing a new succession planning process

The rules for CEO success are already changing. Research suggests that the greater frequency in CEO turnover among higher performing companies indicates that non-financial considerations could be driving more leadership changes. So the question becomes, how can an organization develop an objective succession process that fits this new reality?

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Choosing a selection committee

Deciding who to involve in CEO succession planning is an important first step in an effective succession process. At a baseline level, the succession planning committee should include no more than three or four members and must include those who understand the company's goals and challenges but also are far enough removed to remain objective.

While including a CEO perspective is important, an over-reliance on these individuals can skew the process and limit the lens through which the group views its mandate. That is why boards should limit the involvement of board members who are current or former CEOs in succession planning. This includes the outgoing CEO, who should not be involved in finding and vetting their replacement in all but the rarest instances.

There is another important reason to nurture this broader perspective. The emerging challenges companies will face now and in the future require new types of thinking and fresh perspectives. While all companies engage in capitalism, these challenges will require a wider and longer term worldview than pure capitalism allows and traditional CEO talent maintains.

Whenever possible, companies should tap board members who have successfully worked on a CEO succession in the past. In fact, this is such an important requirement that companies should make such experience a requirement when recruiting future board members even when CEO succession is not on the immediate horizon.

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Identifying candidates

The members of the CEO succession committee must be able to assess candidates with an eye on the future. After all, the candidate will not be guiding the organization as it is today or was yesterday. They will be guiding the organization as it will be tomorrow and over the next several years. To do this effectively, the new CEO must be able to mesh well with the organizational culture, energize people to follow them, and have the ability to develop leaders who can help them realize their vision.

If these required skills and attribute sound intangible and difficult to measure, that is because they often are. The members of the succession committee must recognize that they may have unconscious biases when evaluating candidates on these and other capabilities. And they need to be open to taking steps to overcome those biases, such as asking candidates a lot of questions (even when the answers are ambiguous, unclear or not definitive) and recognizing the limits of their own knowledge of these issues.

Once the succession planning committee has agreed on the attributes necessary for the new CEO, it should consider the question of whether to focus on internal or external candidates or a mix of both. In general, a company that is looking to change direction and boost future performance should focus on external candidates who can bring new perspectives and energy to the CEO role.

In some cases, the committee may want to consider younger, less experienced candidates who demonstrate the ability to deal with emerging challenges related to critical areas of company operations. However, it is important to remember that candidate age is not an issue when that candidate has the right perspective and demonstrates a willingness to engage with core company priorities.

Candidates with a diverse resume may also warrant consideration, depending on the company's future goals. For example, one study found that organizations led by CEOs who have experience in the not-for-profit sector have stronger ESG ratings and outcomes, including higher satisfaction ratings from employees, more green innovations and lower harmful emissions, largely due to their experience serving the interests of a broad group of stakeholders.

Ideally, the committee should consider a slate of four to six candidates, then narrow that list down to two or three finalists for the consideration of the full board. This allows for a more robust discussion of the company's needs and future than simply asking the board to validate a single finalist.

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Moving forward

Change is difficult but it also creates opportunities. Boards that find the right CEO have a chance to put the organization on the path to value creation for years to come. However, that also means that the process for defining executive success and identifying future executive talent is likely to evolve and change more quickly as the markers and drivers of corporate success continue to change.

Boards and succession planning committees must be ready for this transformation to ensure that succession planning remains closely aligned with the company's future goals. Indeed, the changes that have occurred in business and in society at large over the past few years are a good reminder why a dynamic succession planning process is necessary to keep pace with a changing world.

Ensuring success

The process of updating succession planning is challenging and plays out differently for every company. Expanding and changing corporate priorities not only add a new layer of complexity to that process, they also promise ongoing change in the years and decades ahead. Here are some ways companies can increase the chances of getting CEO succession planning right.

- **Look to the past…up to a point.** To increase the chances of a successful succession process, companies and their boards need to do some soul searching. How has the succession planning process worked in the past? What has gone right and what has gone wrong, and why? Honest and comprehensive answers to these questions can provide some important insight into how to handle succession planning in the future and mistakes to avoid.

- **Don't rush.** Succession planning should never be done on the fly. Finding the right CEO can take up to two years and requires ongoing attention. The board's succession planning committee needs time to consider how shifting company priorities fit into the process and how to identify and prepare the executive pipeline for a future that is still unspooling.

- **Get help when you need it.** Given the changes involved, it will take time for boards and companies to become comfortable with a new way of identifying and evaluating executive talent. Bringing in objective outside expertise to support the succession planning process can provide fresh perspectives and insights that complement board members' experience and expertise.

- **Be transparent.** When presenting CEO candidate choices to the full board, it is important to be as transparent as possible about how the committee made these choices. Making sure the board understands both the "who" and the "why" of each candidate can help support its own deliberations and decision making.

- **Look for the right cultural fit.** No matter how much things change, finding a CEO who is the right cultural fit for the organization continues to be of utmost importance. Therefore, it is still important to clearly define what a good cultural fit looks like. If a culture change is one of the reasons for bringing in a new CEO, the board should be clear on the desired culture the new CEO will be charged with nurturing.

- **Set up the new CEO for success.** Hiring a CEO is not the end of the succession planning process. The committee should also develop a short-term plan to help the newly hired or promoted CEO get started. In doing so, it is important to keep expectations realistic. Even a CEO stepping into a well-run company considered to be on the right track will need time to settle in. Those coming into a more challenging situation need that time to succeed even more.

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1 https://hbr.org/2021/05/the-high-cost-of-poor-succession-planning

2 https://www.aicd.com.au/company-policies/environmental-social-governance/esg-investing/leading-in-the-age-of-esg.html

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