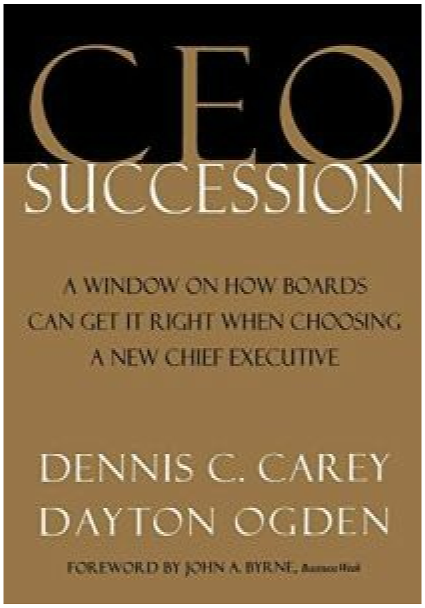

Book CEO Succession

A Window on How Boards Can Get It Right When Choosing a New Chief Executive

Dennis C. Carey and Dayton Ogden
Oxford UP, 2000

Recommendation

Authors Dennis C. Carey and Dayton Ogden present a thorough, insightful guide to choosing a new Chief Executive Officer in this nicely written, concise book. Offering plenty of inside information and real-life corporate examples, the authors explore their ideas without resorting to fluff or to the dry, dull prose that often fills such books. Given their experience helping corporations choose CEOs and other executives, the authors know what they're talking about and understand the tricky issues involved in putting any advice into practice. Their book delivers what it promises, and given that it can be repetitive, it delivers on some of those promises two or three times (but we're quibbling, some of those lessons do bear repeating). *GetAbstract* recommends this book to anyone involved in executive succession and recruitment, especially board members (read it now, before you ditch your CEO, not after).

Take-Aways

- CEOs leave companies for various reasons, including sudden illness or death, performance issues, a move to another business or retirement.
- Executives and boards must have a succession plan.
- A succession plan must provide a seamless transition of leadership.
- CEO succession is an art and a science.
- Without a succession plan, companies can be thrown into turmoil.
- Your company must create a reliable succession agenda and timetable.
- A self-renewing succession culture develops leaders at all levels of management.
- Internal candidates must be groomed for the role.
- Measure internal candidates for CEO and other top posts against comparable outside leaders.
- A strong, involved board should work with the CEO on the succession plan.

Summary

Planning for CEO Succession

CEO succession is both an art and a science. CEOs move on for many reasons, including sudden illness or death, performance problems, a move to another business or retirement. No matter what the reason, your company's executives and board members must provide a seamless transition of leadership, which means:

- Establishing and sustaining a reliable succession agenda and timetable.
- Implementing a self-renewing succession culture that develops leaders at all levels of management.
- Creating a healthy relationship between the board and CEO that keeps the CEO on track.
- Benchmarking internal candidates for CEO and other top posts with comparable outside leaders.

Worst-Case Scenario

In March 1996, Richard Swift, the CEO of Foster Wheeler Corp., a $4.5 billion New Jersey-based engineering and construction giant, was invited by then U.S. Secretary of Commerce Ron Brown to accompany him on a trade mission to Bosnia. Unable to make the trip because of prior commitments, Swift asked Robert A. Whitaker, vice president of Foster Wheeler's Energy Equipment Group and president of Foster Wheeler Energy International to represent the company in his place.

> "Sometimes a decision to bypass the internal team in favor of an outsider is a way for a company to make a powerful statement about fundamental change."

The plane carrying Brown, Whitaker and eleven other corporate executives crashed in the Bosnian mountains, killing everyone on board.

Because Foster Wheeler's board had planned ahead, the loss of this key executive didn't leave a gaping hole in the company's organization, even though the loss was, of course, personally painful to everyone. On a practical level, the company was prepared for something like this. Because Foster Wheeler's board wisely wanted to avoid any long-term disruption in its leadership ranks, it had created a succession plan for its top executives long before the Bosnia trip. The plan was designed to deal with unanticipated events.

> "As the company's strategy shifts over time, so should the roster and ranking of likely CEO successors."

Many other companies, including some that lost senior executives in the Bosnia crash, have faced sudden succession without being nearly as prepared. Among those caught unprepared were ABB, Inc., a subsidiary of Asca Brown Boveri, Ltd., a $31 billion Swiss company whose president and CEO, Robert Donovan, died in the crash. A spokeswoman told The Wall Street Journal that ABB was only prepared for an interim appointment.

> "The science and art of selecting the most capable successor to the CEO has more to do with a vision of the company for the future - and finding a leader who will be capable of bringing that vision to fruition - than its assessment of the past or even the present."

The spokesman for the Bechtel Group, which lost P. Stuart Tholan - senior vice president and president of Bechtel Europe, Middle East and Southwest Asia - said after the crash that he had "no idea" who would succeed Tholan.

Early in the spring of 1996, the CEO of Texas Instruments, Jerry Junkins, was speaking with consultants about succession planning. He explained that no plans were in place for anything unexpected, adding, "I'm healthy as a horse." The company's only plan dealt with his planned retirement, two or three years in the future. He didn't see the need for any other kind of planning. A few months later, while he was visiting a customer in Europe, Junkins died of a massive heart attack in the backseat of his car. Left without an immediate successor, Texas Instruments was thrown into turmoil.

> "If a company is suffering losses, declining share price, bad media or other problems, shareholders may conclude not only that the CEO isn't right for the company but that the strategy isn't either."

Despite the growing emphasis on thorough succession planning, almost no practical information is available on the subject, leaving companies to try to figure it out on their own, reinventing the wheel each time they begin the process. The cornerstone of any succession plan is identifying who will be an executive's successor in the event of the need for immediate succession. Choosing that person is part of a larger, overall plan.

What Works?

Systematic steps and best practices undertaken by leading companies demonstrate some effective components of a good succession plan:

- Establish a board that isn't afraid to challenge the CEO if necessary. A strong board will take a major role in crafting and maintaining momentum for a well-thought-out succession plan.
- Don't view succession planning as a phenomenon limited to only the very top of an organization. An organizational process that continually emphasizes identifying high-potential executives and providing them with opportunities to grow and develop is integral to any succession plan. You want to make sure that your leadership well doesn't run dry.
- Keep the board up-to-date about high-potential employees at all levels. At regular intervals, the board of directors must prod the CEO about the development process, particularly when it comes to grooming potential CEO successors.
- Even companies with strong cultures that have been highly successful in leadership development are increasingly calibrating internal candidates for CEO against comparable outside leaders, a practice called "global intelligence."
- Consider structuring specific financial incentives to assure success in succession planning.
- Avoid practices that can undermine the succession process, such as appointing a director as CEO. Consider this a practice of last resort, since having board members who aspire to be CEO can create unnecessary conflict and politicize the succession process.

  "No succession process proceeds in a vacuum. It is closely linked to other critical corporate processes, particularly the determination of strategy."

When creating succession plans, consider the following trends shaping the current executive hiring environment:

- The emerging predominance and power of outside directors on corporate boards;
- Constant cries from the media and shareholder activists for these directors to fulfill their fiduciary duties and provide a stronger counterbalance to the CEO;
- The increasingly high turnover and generally short tenure of CEOs of major public companies (one recent study says the average tenure of a CEO at a Fortune 100 company is seven years);
- The growing realization that ensuring continuity of leadership is a board's most important responsibility.

  "Well-planned successions start with a thorough delineation of business strategy, which then serves as a road map for the rest of the process."

Given these trends, you can see why more and more boards are taking control and establishing the agenda for the succession process. This process calls for a delicate balance between the board and the CEO.

Best Practices

International research demonstrates that companies that take succession planning seriously follow these ten best practices:

1. They have strong, involved boards that work with the CEO on the process.
2. They continually expose their top-management team to the board so potential candidates aren't strangers to those who are will participate in the choice of successor.
3. They encourage "next-generation CEOs" to gain exposure to outside board service, to the media and to the investment community. This helps shape their understanding of the proper relationship between a board and management, and of critical outside forces.
4. They form executive or operating committees to facilitate the development of several executives who are aware of challenges, business plans and strategies across the entire organization. Some firms with effective succession plans ask CEOs to develop

small teams of insiders who become interchangeable through learning and cross training.

5. They view succession planning as an ongoing and real-time process. Their boards and CEOs communicate regularly (at least one or two times a year) on a formal basis to determine who would likely be in line to take over in the event of a crisis. These discussions are part of the strategic planning process to ensure a fit between where the business is going and the skills of the successor.
6. They take the human drama out of the succession process. They try to build in as much predictability as possible. Companies reduce the risk of losing a valuable top executive when the CEO successor is named by openly communicating succession plans and timing to probable successors, encouraging a team leadership approach and reducing "horse races" among top contenders.
7. They link the CEO's compensation to the development of succession plans. Their boards require the CEOs to report regularly on succession-planning activities with various contingency plans and formally link this to their bonus opportunity. Some companies are beginning to attach a specific formula (up to one-third of total bonus opportunity) based on their success in this area.
8. They pay their directors increasingly in stock and require directors to make a personal investment in the company. Directors take succession more seriously when their own economic interests are at stake.
9. They periodically calibrate likely internal candidates for CEO against comparable outside leaders. This helps ensure that the best possible leader is tapped from the broadest possible universe. This process is vital in companies that are undergoing substantial change, particularly where outside experience may be critical to executing a new strategy or changing the momentum or direction of the business.
10. They develop a succession culture. They take CEO succession seriously and their boards and CEOs require all organizational levels to plan for the inevitability of change.

Financial Tools for Succession Planning

Your board of directors can use these financial tools to provide incentives to the participants in the succession-planning process:

- When designating specific areas to be given weight in CEO performance appraisals, assign a high priority to succession planning and to involving the board in that process.
- If an heir apparent has been officially designated, consider linking his or her performance appraisal and compensation formula to the current CEO's, and revising compensation to reflect changing responsibility.
- When a strong potential Number Two has been turned down for the position of CEO, determine the priority of retaining him or her, and adjust compensation accordingly.
- Devise packages tied to profitability, and timed to ensure the executive's retention through an extended transition period, long enough to provide the new CEO with the support required to ensure leadership stability.
- Bonuses should meet the performance-based criteria required in the revised tax code.
- Move toward significant director share ownership, primarily through compensating directors with equity. Shift away from compensation arrangements that treat directors as employees, such as directors' pension plans.

> "In selecting a CEO, a company must look not just at the business environment in which it has traditionally operated, but also at the ways in which it is changing."

These financial tools aren't just incentives, they're reminders that the process of selecting a new CEO - and making the choices that follow - have a major impact on the company financially and can lead toward failure, stagnation or success.

About the Authors

Dennis C. Carey specializes in the recruitment of CEOs and corporate directors for major U.S. corporations. He is Vice Chairman of Spencer Stuart, a global executive search firm. He is a co-founder of the Director's Institute at the Wharton School, University of Pennsylvania. **Dayton Ogden** is co-chairman of Spencer Stuart and has previously served as the firm's CEO and Chairman of the Strategy Committee.