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Center for Board Effectiveness

On the board's agenda | US

The never-ending story: CEO succession planning

Deloitte's Chief Executive Program has engaged in a series of dialogues with current CEOs as well as those who are (or were) considered for CEO roles. The following is a high-level thematic summary of the Program's work on succession planning, with a focus on how boards might improve their strategy in this area.

It is no secret that the number of areas involving board oversight has increased dramatically, especially in recent years. The role of the corporation in society, workplace strategies, and climate change are just some of the newer topics that boards are expected to address. And of course, this is in addition to the many perennial items of governance like risk management and guiding the company's long-term strategy.

It may be a truism to say that every topic on the board's agenda is important. But governance experts generally believe that CEO succession is among the most important director responsibilities.[1] The CEO is usually the most visible and prominent position within a company.[2] When things go well, an effective succession planning strategy can result in a CEO with transformative leadership potential who executes on the company's long-term vision and adds value for shareholders and other stakeholders.[3] And, just as importantly, business history is littered with cautionary tales of what can happen when the succession process goes awry.[4]

What is the board's role in CEO succession planning?

It's a unique role and one of the highest-priority activities in which the board engages; after all, this is one of the most highly visible positions in any company. At the same time, the position cannot be viewed in isolation; boards also need to think about the rest of the management team. Being holistic in this area means considering whether the incoming CEO, when combined with other key members of the executive team, have the set of qualities that are most valued by the company's stakeholders.

What candidate qualities and characteristics should boards look for when selecting the next CEO?

Talent is a huge part of it, but it's more than that. Types of guiding questions to ask in this area include: How does talent fit with the company's strategy and vision? What is happening at the company? What are its needs given its industry, history, maturity, and other unique characteristics?

There has been a shift in what boards look for in CEO candidates. In the past, boards often looked for a strong leader with a fixed, specific point of view. This might best be characterized as a dynastic succession model, which "grooms" a specific candidate for the CEO role.[5] Such approaches can have merit, and some research does link this type of succession with improved firm performance.[6]

1 Kristin V. D. Berns and Patricia Klarner, "A review of the CEO succession literature and a future research program," *Academy of Management Perspectives*, May 2017.

2 Jay W. Lorsch and Rakesh Khurana, "Changing leaders: The board's role in CEO succession," *Harvard Business Review* 77, no. 3 (May 1, 1999): pp. 96–7.

3 Dennis C. Carey, Dayton Ogden, and Judith A. Roland, *CEO Succession: A Window on How Boards Can Get It Right When Choosing a New Chief Executive*, 1st edition (Oxford, UK; New York: Oxford University Press, 2000).

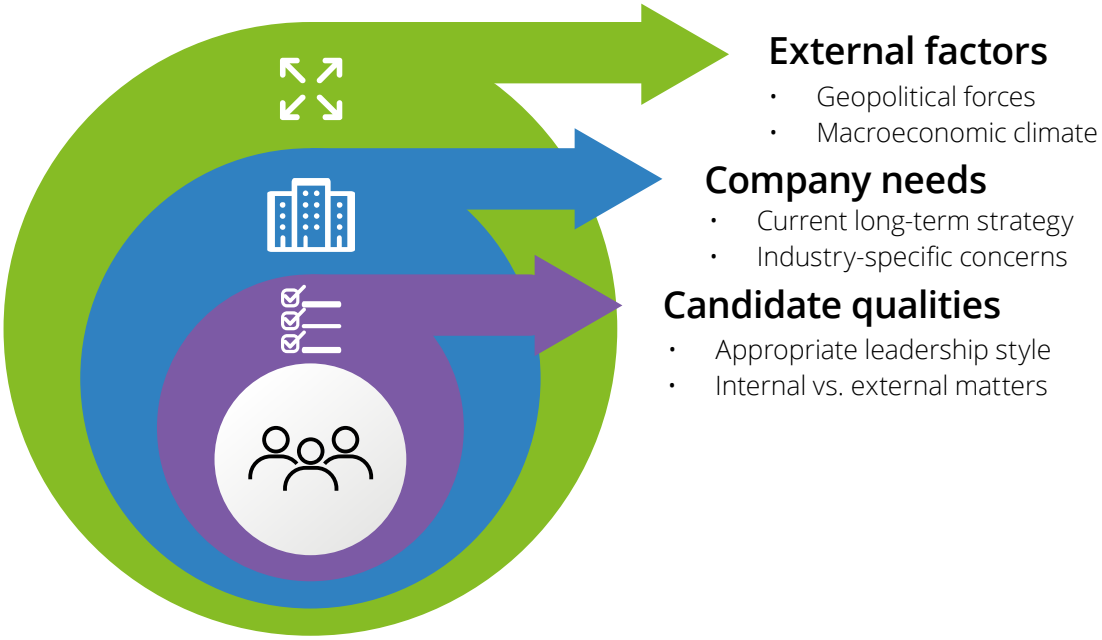
4 Ram Charan, "Ending the CEO succession crisis," *Harvard Business Review*, February 2005.

5 Yan Zhang and Nandini Rajagopalan, "When the known devil is better than an unknown god: An empirical study of the antecedents and consequences of relay CEO successions," *Academy of Management Journal*, August 2004.

6 Ran Tao and Hong Zhao, "'Passing the baton': The effects of CEO succession planning on firm performance and volatility," *Corporate Governance: An International Review*, July 3, 2018.



Factors to consider during the CEO succession process



However, the shifting geopolitical and economic context of today's operating environment means prioritizing different qualities, such as openness to innovation, humility, and agility. Thus, as both board members and companies have become more adaptive, so too has the candidate selection process.[7] As a result, some boards might consider casting a wider net and designing a selection process around multiple competitive candidates.

What about the ***process*** of CEO succession planning—what is the board's involvement relative to other stakeholders?

In terms of the process itself, the structure will and should vary based on a company's culture, norms, and industry. Based on conversations Deloitte's Chief Executive Program has had, though, board members should keep the following things in mind:

- **Use of third parties:** Boards want to be as objective as possible in selecting a new CEO. To accomplish that, many engage search firms or other outside consultants. In some cases, adding a third party has the potential to create distance between the candidates and the board, which can limit exposure between both sides. Ideally, though, the search process should be adaptive enough to adjust for this if it becomes a concern.
- **Timing:** On average, companies start working on succession planning about two years before the current CEO's planned departure. Starting earlier or later than that depends on circumstances. One important consideration for timing is how an extended succession planning process may be perceived by the incumbent CEO and the company's stakeholders.
- **Existing management's role:** Some boards are intentional about talking with other c-suite executives ***not*** in contention for the CEO role. The form of this engagement varies, but 360 reviews can be very helpful in the process. Incorporating perspectives from this level of management can also give a more holistic sense of the leadership qualities of internal candidates.
- **Balancing internal versus external candidates:** Boards often want to consider both categories of candidates. And given the importance of the CEO role, it's justifiable. This is an area for which the importance of having a long-term plan in place becomes very apparent. Some companies have a culture and preference for internal candidates—but sometimes there are no qualified candidates available. According to a joint survey by Fortune and Deloitte, only about 54% of CEOs believe their company has a strong slate of future CEO candidates.

7 Juehui Shi and Jurriaan de Jong, "Insider or outsider? The separate and joint effects of firm performance and diversification on CEO recruitment," *Journal of Management and Governance*, April 23, 2019.



What is the best way to manage communication with candidates who aren't selected?

As with many areas of this process, communication with candidates who are not selected is key. The selection process for CEOs is inherently competitive. Sometimes, the constellation of qualities that are needed means an individual may be highly qualified but just not a good fit for the CEO role at the time. After all, boards want to see a combination of qualities that can be hard to find in a single individual: agility, resilience, team leadership, and vision.

But while communication and transparency are important for everyone in the process, they are especially key for internal candidates. Otherwise, internal applicants who are not selected could see it as an indictment of their leadership or work quality. That can result in talent loss by prompting high quality (if not quite ready - yet) internal candidates to seek opportunities with other companies.

For those who are interested in CEO positions, what are the best ways to be competitive?

Many prospective candidates are starting to work extensively with coaches and mentors who specialize in CEO-level roles. In addition, sometimes serving on another company's board can provide future candidates with a valuable perspective on the ties between governance and succession planning.

Finally, especially for candidates, it can be important to remember that CEO selection involves many parties with varying sway in the decision-making process. For instance, in most cases the outgoing CEO will have an influential voice in the selection of his or her successor.[8] Sometimes even if a candidate seems otherwise qualified, the individual is unlikely to be selected without a strong vote of confidence from the current CEO. That vote matters even more when you consider that retiring CEOs often stay on as executive chair or in a similar capacity.

8 Ormonde Cragun, Anthony Nyberg, and Pat Wright. "CEO Succession: What We Know and Where to Go?" *Journal of Organizational Effectiveness: People and Performance*, January 1, 2016.

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