Chartered Accountants of Canada

20 Questions Directors Should Ask about **CEO Succession**

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20 QUESTIONS

How to use this publication

Each "20 Questions" briefing is designed to be a concise, easy-to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors which includes asking management — and themselves — tough questions.

The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics. The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper as necessary.

The comments summarize current thinking on the issues and the practices of leading organizations. Although the questions apply to most medium to large organizations, the answers will vary according to the size, complexity and sophistication of each individual organization

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Preface

The Risk Management and Governance Board of the Canadian Institute of Chartered Accountants commissioned this document to help boards of directors discharge their governance responsibilities in the area of CEO succession.

This publication is intended as a resource to assist directors in:

- identifying best practices in CEO succession planning;
- better preparing themselves to participate in CEO selection decisions; and
- working through sudden or unplanned CEO transitions.

This document provides questions that directors may ask to focus thought and discussion on the issue of CEO succession. Each question includes an explanatory background and some suggestions.

The key ideas outlined in this publication are relevant to all organizations in all sectors. In applying these ideas, however, directors are encouraged to adapt them to reflect the size, sophistication, ownership structure, available resources and other characteristics of their organization.

The Risk Management and Governance Board acknowledges and thanks the members of the Directors Advisory Group for their invaluable advice, the authors Drs. Peter Stephenson and Guy Beaudin, and the CICA staff who provided support to the project.

Tom Peddie, FCA
Chair, Risk Management and Governance Board

Introduction

Selecting a new CEO is one of the board's most important responsibilities and one of the ways in which it can most significantly and directly influence an organization's fortunes.

In public companies, the board has the sole legal responsibility for appointing a new CEO. In private and not-for-profit organizations, boards also often have ultimate responsibility for hiring the CEO and they are increasingly influential in choosing CEOs in the public sector.

For many directors, dealing with CEO succession may be a new or at least infrequent experience. Most directors, however, will likely deal with at least one incident of CEO change over the course of their directorship. A recent study, for example, indicates that the average tenure of a North American CEO is almost 10 years[1] while Canadian studies have found the average tenure for CEOs to be approximately five years.[2]

Given the importance and predictability of CEO succession, organizations should ideally have a well mapped out plan in place for identifying and developing their next CEO. Research indicates, however, that fewer than 50% of companies actively engage in succession planning for their CEO.[3] It is not surprising, therefore, that a recent survey of directors found that 40% of directors considered their involvement in CEO succession planning as less than optimal; and just 21% said they were satisfied with their level of participation in developing internal candidates for senior management.[4]

1 "CEO Succession 2006: The Era of the Inclusive Leader", Chuck Lucier, Steven Wheeler & Rolf Habbel, Strategy + Business, 47, Summer 2007.
2 "2006 Board Index", Spencer Stuart, 2006.
3 "Grooming for the Top Post and Ending the CEO Succession Crisis", Yan Zhang & Nandini Rajagopalan, Organizational Dynamics, 35 (1), 96-105, 2006.
4 "Ending the CEO Succession Crisis", Ram Charan, Harvard Business Review, February, 2005.

The challenging task of managing CEO succession is further complicated by the variety of unplanned events that can trigger a change of CEO, such as a CEO's inadequate performance, sudden illness and being "poached" by another organization. Recent data indicate that less than half of CEO departures are due to planned retirement (46%), while the majority are due to poor performance, mergers or other factors.[5] In these unplanned situations, boards are often under particular pressure to quickly fill the leadership void.

Since CEO succession is both a primary board responsibility and one of the board's greatest opportunities to affect the performance and the future direction of the organization, it is critical that boards treat succession planning as an ongoing agenda item, and not as an event. A sound succession process, with clearly articulated roles and a three to five-year time frame, is one of the basic elements for success. When the succession process is done well, it can serve as an opportunity for the board to take stock of the organization and its future, and be a time of renewal for the organization and its employees.

5 See "CEO Succession 2006" above.

CEO Succession is the Key Board Responsibility

Most directors readily acknowledge that their jobs have become more complex and demanding in the last five years. They also agree that few board decisions are more important than the selection of the CEO. For this reason, directors should view CEO succession as an ongoing and core governance responsibility rather than a periodic "event." Once they have adopted this mindset, directors should ask the following questions to help them in fulfilling this responsibility effectively.

1. What succession-related factors should be on our radar?

Directors need to begin with a clear understanding of the CEO succession-related factors they should be aware of, and review and evaluate them on an ongoing basis. Although boards will already monitor some of these issues for other purposes, periodically, they should pay specific attention to them in the context of a CEO succession in order to remain vigilant and prepared for possible succession scenarios.

Directors should track:

1. their organization's strategy and competitive environment;
2. the universe of possible successors, both inside and outside the organization; and
3. their current CEO's strengths, limitations and performance.

Any CEO succession planning process must start with a thorough analysis of the organization's strategic and competitive environments. The board's task when selecting a CEO involves determining how well an individual candidate's strengths and limitations fit with the organization's needs and requirements. In thinking about fit, directors should focus both on the organization's strategic direction (as approved by the board) and the obstacles the organization is likely to encounter in executing that strategy. Both are important in anticipating the leadership needs of the business.

A careful monitoring of the environment also helps directors remain vigilant about the characteristics the current CEO must have in order to successfully navigate that environment. Thinking through the leadership implications of the business strategy and the challenges that face the business better prepares directors for the tasks of both assessing the current CEO and selecting a suitable successor when the time comes to do so.

2. Are we, as the board, responsible for overseeing the development of internal CEO succession candidates?

The short answer is an unequivocal "yes."

Research indicates that organizations that embrace succession planning and have an "heir apparent" for the CEO role (sometimes referred to as "relay succession"—passing the leadership baton smoothly from one CEO to the next) also experience higher levels of performance.[6] Other research has found that, while externally selected candidates may bring higher short term rates of return, internally selected candidates bring higher returns over time.[7] These findings should encourage all directors to adopt the practice of investing the board's time in the ongoing oversight of the development of top talent and in planning for CEO succession as one means of fulfilling their fiduciary responsibility.

3. What is our role in the development of internal CEO successors?

Boards should play two distinct roles in the development of internal CEO succession candidates.

First, the board should ensure that the current CEO has an appropriate talent development process in place to identify, develop and retain high potential individuals who are capable of acting as CEO. Either the board or its Human Resources/Compensation Committee should engage the CEO in in-depth discussions about the top talent development process and the actual development of key succession candidates.

Second, the board should conduct its own independent assessment of the progress and readiness of the potential CEO succession candidates. It is recommended that directors invest time both inside and outside the boardroom with their organization's high potential individuals.

6 "CEO Succession 2005: The Crest of the Wave", Chuck Lucier, Paul Kocourek & Rolf Habbel, Strategy + Business, 43, Summer 2006.

7 See "CEO Succession 2005" above.

Here are four suggested ways for boards to strengthen their knowledge of their high potential talent pool.

i) Spend time with high potential talent in a variety of settings

Boardroom presentations may give directors a good idea of an individual's presentation skills and knowledge of the business, but spending time with that person in informal discussions about strategy and business plans gives directors a chance to assess their thought processes and ability to think on their feet. By creating opportunities to spend time with executives in social situations or on company-related business trips, directors can gain useful insights into individuals' leadership and interpersonal styles. Some boards also believe they should have a "line of sight" to longer-term talent development, which they achieve by regularly having members of the second or third tier of management attend and make presentations at board meetings and attend board social functions.

Many boards supplement their own insights into top talent by also requiring professional assessments of candidates. In another emerging practice, directors gain firsthand exposure by observing key executives with their own teams within their own work environments, which provides directors with the opportunity to assess many more dimensions of leadership, including how the team responds to the executive. In some organizations, directors attend business reviews to gain this exposure. Care needs to be taken in setting up these types of meetings, however, in order to minimize the disruption the director's presence may cause to normal day-to-day business processes.

ii) Get to know the individuals over time

While it is important to see individuals in a variety of settings, it is equally as important to get to know them over a period of time. Over the course of a series of meetings, the natural formality that initially exists between executives and directors will diminish, ultimately giving directors a more accurate picture of the executive's strengths and limitations.

iii) Have several board members spend time with the high potential talent and share their perceptions regularly

This is a well-established principle in leadership assessment. We all assess talent from the perspective of our own preferences and biases. The impact of these biases can be limited by having several board members meet with and share their perceptions about high potential talent.

iv) Establish clear guidelines for board-management interaction

Many CEOs are sensitive to interactions among directors and members of management when it occurs outside the boardroom. Boards, therefore, must be sure their CEOs understand and agree with the board's need to have first-hand exposure to high potential talent. One means of achieving this is for the board and the CEO to jointly agree upon the succession process and annual talent review plans.

The most important thing a board can do to ensure a successful CEO succession is to assure itself of the identification, development and retention of high potential talent in the organization. Given the time required to develop internal candidates successfully, it is important that potential CEO talent is identified early and nurtured diligently. As a rule of thumb, in larger organizations the board's Human Resources Committee should spend one-third of its time on the top 20 candidates and high potential executives, and the board should spend 15% of its time on succession.[8]

While the activities outlined above are important aspects of the board's role, directors should remember that it is the CEO who has primary responsibility for establishing and driving a robust internal succession planning process. The responsibility of directors is to develop an independent perspective on the leadership talent in the organization, ensure that a talent development process is put in place, monitor and review the organization's progress against that process and, when the time comes, decide upon each internal candidate's ultimate fit with the role of CEO.

8 See "Ending the CEO Succession Crisis" above.

4. How should we monitor the external talent pool?

In addition to monitoring internal talent, directors should also monitor the organization's competitors and other players in its industry, including key external talent. It is important for the board to know which of these organizations are high performing and the talent that is instrumental in driving their success: who are the key players and where the up-and-coming talent resides. This information is valuable as a benchmark for the board to use in its ongoing assessment, development and retention of the current CEO and CEO succession candidates. It also enables the board to be more prepared and nimble should it be faced with a sudden, unexpected CEO transition.

There are two means by which the board can help ensure that it has current, accurate information on external talent. First, directors should periodically pool the knowledge each of them has acquired about external talent from their respective networks. Often, a board will find that, amongst its directors, it is aware of most of the talent territory in their industry or sector. Second, directors should consult periodically with an external advisor who is familiar with the executive talent pool in the external market. Together, the board and its advisor can compare their lists of known talent and exchange insights about the individuals on these lists. External advisors are also a good source of information on the leadership talent that may exist in related sectors. These individuals should not be overlooked, especially if the company is expected to experience a significant strategic change or other situation in which it would benefit from the perspective of someone from a different industry.

When monitoring external talent, it is important that the board manage this task with care and sensitivity because some CEOs and succession candidates may perceive these activities as threatening. To mitigate this risk, the board's monitoring of external talent should be conducted in a manner that is transparent to the CEO and involves the company's senior human resource executive in the process in order to leverage his or her knowledge of the external market.

5. Do we understand and anticipate the limits to our CEO's abilities?

Leadership success is situational. Every leader has a strategic context in which he or she is more successful; similarly, every leader also has some contexts in which he or she is less able to lead effectively. This is borne out when the statistics on CEO turnover are analyzed. Many unplanned CEO departures occur as a result of two situations: either the CEO sets a strategy that is inappropriate to the company's market and competitive situation or the CEO is unable to navigate the company's culture when executing a particular strategy.

Typically, boards of public companies are slow to make decisions about a CEO's poor performance and often do so only after the markets have pronounced their judgment. This situation may be avoided if the board focuses on two key questions: "What is our current CEO's leadership range?" and "What factors in the competitive landscape may take the company out of the CEO's leadership range?"

In order for directors to be able to anticipate the timing of CEO succession, they must first have a solid grasp of the current CEO's leadership capabilities. They need to rid themselves of the notion that a talented CEO can be successful in any context. Instead, directors must clearly understand what the current CEO does well, and what his or her limitations are.

It is also important that the board have an annual discussion with the CEO about his or her planned timing around retirement. It is also a good idea for the board to develop an understanding of the anticipated succession timing of each member of the management team to help avoid concurrent senior departures, especially those of the CEO and the CFO.

Whenever the organization's performance creates the need for a significant change in strategy or culture, the board must seriously consider whether the current CEO has the ability to adapt to these conditions. Monitoring the strategic and competitive environment helps the board anticipate when conditions may arise that fall outside the range of the CEO's skills. By proactively assessing the organization's performance, its operating environment, and the CEO's skills, the board can be vigilant of situations that may require increased coaching and counseling for the CEO to help him or her address the key issues. Sometimes, however, situations will occur when additional counseling may not be enough for the CEO to be successful.

Boards should watch for red flag indicators that may suggest the CEO will be unable to "flex" his or her skills and abilities beyond the organization's current strategic or cultural situation. Examples of these red flags would include:

- The CEO fails to recognize that a cultural, competitive, or other environmental shift is occurring.
- The CEO minimizes the importance of the shift.
- The CEO is unable to articulate how his or her leadership needs to change to deal with the change in context.
- The CEO neglects to make requisite changes in the organization to reflect its shifting needs.

FOR MORE INFORMATION, SEE THE DISCUSSION OF EARLY WARNING SIGNALS IN THE CICA PUBLICATION *20 QUESTIONS DIRECTORS SHOULD ASK ABOUT CRISIS MANAGEMENT.*

The appearance of any of these red flags, which are sometimes accompanied by lagging organizational performance, may mean it is time to change CEOs. Boards that are able to gauge when a CEO's skill set may no longer be adequate will be better positioned to appropriately manage the transition to a new CEO instead of being forced to terminate the CEO without having a successor ready to take over. For this reason, explicit, ongoing discussions between the board and the CEO on these topics are essential to the succession planning process, yet most boards shy away from these discussions for fear of offending the CEO. While it is true that these conversations can be challenging, that challenge pales in comparison with the costs of *not* having had those discussions.

A key tool boards can use to facilitate these discussions is the CEO evaluation. Boards should ensure that they have put in place a rigorous annual CEO evaluation process that examines performance, development needs and how well the CEO's skills and experience fit with current and potential challenges facing the organization. In addition, an objective, third-party assessment of the CEO's abilities can further enhance the board's understanding of the range of conditions that the CEO can navigate successfully.

It is good practice for the board to essentially "re-hire" the CEO every year. This process provides the board with experience in identifying and addressing the issues related to the current CEO's performance and skill set, and helps the board ensure that the CEO's performance and skills are appropriate in light of current and expected strategic conditions.

Planned Succession: The Board's Roadmap for Selecting a New CEO

When a transition approaches, the board's role will shift from one of gathering information about potential talent and key issues facing the organization and monitoring them against the current CEO's performance to one of active decision-making. If they have already invested time in succession planning, however, directors should be well prepared to deal with a "planned succession" – when a CEO transition is triggered by an anticipated event, such as the current CEO's normal retirement.

Choosing a new CEO typically requires making decisions that involve a significant amount of subjective judgment. When boards face situations involving subjective judgment, it usually helps to have an agreed upon, robust process in place to guide the decision-making. Therefore, once the succession has been triggered, boards should first develop and agree on the process they will follow to select the new CEO.

This process should reflect the organization's size, culture and ownership; as well as the board's own dynamics and the strength of the internal CEO candidates. It should also be designed to work effectively, without being over-engineered.

The most common mistakes to avoid when selecting a new CEO include:

- starting the process based on untested assumptions about the requirements of the CEO role
- overly relying on the current CEO's assessment of internal talent
- overly relying on an executive search firm
- favouring expediency over thoroughness
- not addressing CEO performance issues directly or quickly enough

6. What is our role, as the board, in choosing the new CEO?

The board is responsible and accountable for selecting the CEO. This is not the responsibility of the former CEO or other members of management. In fact, the selection of a new CEO is one of the board's most important responsibilities, and boards that take time at the start to clarify responsibilities, processes and timelines will be better able to fulfill this responsibility successfully.

One of the board's first considerations in developing its selection process is to determine what, if any, responsibilities will be assigned to specific individuals or groups. The board's selection process—and its allocation of responsibilities—may be quite straightforward if the board's succession planning activities have already identified a single internal candidate who appears ready to assume the CEO mantle. The process will be more complex, however, in situations where no internal candidates have been identified, the identified internal candidates are not considered ready to take on the responsibilities of CEO, or the board wants to benchmark the internal candidates it has identified against the external market.

In more complex succession situations, medium to large-sized boards frequently appoint a CEO Search Committee to oversee and do a considerable amount of the "staff work" involved in selecting a new CEO. In some cases, this may be the Governance and Nominating Committee. Smaller boards, on the other hand, often choose to approach CEO selection as a committee of the whole. The board must discuss and agree upon the roles and responsibilities of the Search Committee, Search Committee Chair, the full board and any others who will be involved in the process. The board should also establish broad timeframes and outputs for the process. In addition, since a change in CEO is usually considered to be a material event that requires public disclosure, the board needs to ensure that a communication plan is developed, which includes the assignment of responsibilities for creating and communicating key messages to various stakeholders.

In matters of CEO succession, the board chair plays a particularly important role, which is often time consuming, especially in a crisis situation. The chair is responsible for ensuring that the right committee is struck, the integrity of the process is respected, the various stakeholders are engaged appropriately and the full board is informed about and aligned with the process at all times.

FOR MORE INFORMATION ON THE ROLES AND RESPONSIBILITIES OF MEMBERS OF THE BOARD AND MANAGEMENT IN THE CEO SUCCESSION PROCESS, PLEASE SEE APPENDIX A.

7. What is the role of the CEO Search Committee?

Conducting a CEO search that involves external candidates, several internal candidates or both is a time-consuming and intense process. The timeframes associated with meeting and interview schedules can be demanding. For this reason, many boards choose to assign these responsibilities to a special search committee which it creates to take on these tasks on the board's behalf. If, however, the board chooses to take on these tasks as responsibilities of the full board, directors will need to recognize and plan for the additional work they are assuming.

A CEO Search Committee's responsibilities typically include:

- fleshing out the details of the search process;
- creating a CEO Leadership Profile that defines the competencies, attributes and experience necessary for success (a model is provided in Appendix B and a sample in Appendix C);
- identifying and contracting with any external resources involved in the process (e.g. search consultant, compensation consultant, etc.);
- identifying and interviewing potential candidates;
- keeping the full board apprised of the search process;
- recommending final candidates to the board;
- facilitating the board's decision-making process about the finalist candidate; and
- facilitating the board's offer to the finalist candidate.

Care should be taken when choosing the directors to serve on the search committee. To be effective, they must have a deep knowledge of the organization, its culture and its challenges. These directors need to demonstrate sound insight into, and the ability to be objective about, their own biases. The search committee members should also be inclusionary team players: they need to ensure that all directors are appropriately involved in providing input to the CEO Leadership Profile, are tapped into as sources of potential candidates, are kept apprised of the progress of the search, and are appropriately involved in the decision-making process, as agreed upon with the full board.

FOR MORE INFORMATION, SEE *20 QUESTIONS DIRECTORS SHOULD ASK ABOUT SPECIAL COMMITTEES.*

8. What does our "ideal" CEO look like?

CEO selections frequently take on a sense of urgency because of the anxiety that arises from having a leadership void at the top of the organization. This can cause directors to pressure themselves, or bow to external pressure, to quickly begin identifying and interviewing prospective candidates. CEO searches that bog down or become derailed, however, usually do so because the board either failed to take the time to develop a profile of an ideal CEO or did not do so with adequate thoroughness.

An important early step in the CEO selection process is to define the organization's leadership requirements. The board or its search committee needs to create a "leadership profile of success" to serve as the blueprint for the search and selection processes (a model of a CEO Leadership Profile is included in Appendix B and a sample profile is in Appendix C). The definition of the competencies, skills, attributes and experience base sought in a new CEO is crucial and the board must take a high degree of ownership for it. Creating the profile is a key board responsibility, and it should not be delegated to the organization's human resources group or external consultants, although both may be able to offer useful input.

The selection of a new CEO presents the board with important opportunities for introspection, and to reflect upon and define the leadership needs of the organization. In developing its profile of the skills and attributes of its ideal CEO candidate, the board should consider the organization's strategy, strategic challenges, stage of maturity, depth of talent, history and culture. The profile should also explicitly address the impact of the current CEO's style and legacy.

If the board has formed a search committee, that committee needs to engage the full board in providing input and approving the CEO Leadership Profile. Involving the full board in this activity helps to ensure that all directors agree on the assessment of the challenges facing the organization and the type of CEO best able to successfully lead the organization in addressing those challenges.

When they are creating a CEO Leadership Profile, boards should be careful about becoming too idealistic in their expectations. The board needs to be aware of and conduct a "reality check" on a number of assumptions that often arise in the early stages of the search process. Some common mistakes to guard against:

- Seeking a caliber of candidate who would not be interested in becoming the organization's CEO.
- Seeking a caliber of candidate the organization could not afford given its market conditions.
- Believing the ideal candidate must already be a CEO.
- Believing the candidate will, on his or her own, be able to create the success the organization hopes to achieve.

The first two factors may be issues for the board depending upon the organization's reputation, size and profitability, and the fourth factor is rarely ever true under any circumstances. Nevertheless, many boards tend to behave as though these limitations do not exist. By pragmatically challenging these assumptions, boards can refine their CEO Leadership Profile and/or the proposed search process accordingly.

At this stage, before any candidates are interviewed, directors should prioritize the elements included in their CEO Leadership Profile and agree upon those aspects of the profile that are non-negotiable and those where certain trade-offs may be possible.

9. How do we determine the "readiness" of internal candidates?

Directors of organizations that have robust succession and talent development processes usually have an up-to-date understanding of the potential internal candidates for the CEO role. The challenge they face is determining how ready the individual candidates are to assume the CEO responsibilities.

Directors should obtain input from a wide number of sources about each of the organization's internal candidates. This input may be gathered first hand through interviews, candidate presentations about specific business issues, etc. Some of those who may also provide the board with valuable input about the readiness of potential candidates include members of senior management, the organization's human resources department and the outgoing CEO. The board should then use its CEO Leadership Profile as the basis for organizing the input received from its various sources and assessing the potential and readiness of each internal candidate. In doing so, the board should seek to answer three key questions: how well does the candidate fit the profile, where do gaps exist between the candidate's attributes and the profile, and what is the candidate's potential for developing quickly enough to fill those gaps?

When communicating and interacting with internal candidates, the board must take care to ensure that the process is seen by all participants as being transparent, fair and professionally managed. Often, the outgoing CEO can provide valuable assistance to the board in communicating and dealing with internal candidates. For their part, directors need to interact with the internal candidates with candor and sensitivity. The objective is to engage internal candidates in a way that keeps them motivated and aligned with the goal of finding the "best" CEO for the organization. "Aspiring" candidates—high potential individuals who want to be considered but are not yet ready for the role of CEO—and unsuccessful candidates need to be provided with constructive feedback so they feel they have received some personal benefit from "throwing their hat into the ring." It is also important to ensure that the unsuccessful candidates will be supportive of the person who is ultimately selected as CEO.

Two areas can be particularly sensitive in this process. The first is whether or not to make potential candidates aware of the fact that they are on the succession list. This is generally recommended. One principle in the development of high potential individuals is that their work should be visible and have real consequences attached to it. Another principle is that high potential individuals should be given assignments that cause them to "stretch" and which provide them with a broader perspective of the organization. None of these objectives is easily accomplished when the succession process is not open and transparent.

The second issue is the fear that executives who are not considered to be possible successors will leave the organization. This is always a possibility and one that cannot be completely avoided. The best policy is to be honest with these individuals. Let them know where their skills sets are most useful and that the organization remains committed to their ongoing progress and development. If their ambition is to get the top job, it may be impossible to keep them, which is a good reason to have a succession process that goes down a few levels in the organization.

10. Do we need to look for candidates externally?

Approximately one-third of CEOs are recruited externally. Research has shown, however, that CEOs recruited from outside their organization are more likely to fail than those who have been recruited internally.[9] In most instances, externally recruited CEOs fail because of a lack of fit: they are unable to gain the trust and credibility needed from management and/or the board to lead the organization forward.

Many directors believe a lack of internal candidates for CEO reflects the board's failure to effectively manage the CEO succession. With a full understanding of the risks involved, however, there are many reasons why a board or search committees may choose to look at external candidates:

- The internal candidates with the potential to become CEO are not yet ready to take on that role. In these situations, boards may look for a seasoned CEO to serve for a set period of time in part to mentor and prepare internal candidates.
- The organization is either small or mid-sized. These companies often lack the scale or resources necessary to support the internal development of CEO candidates.
- The board wants to calibrate and benchmark the organization's internal candidates with potential external candidates.
- The organization requires a significant change in strategy and direction. Often, when companies face financial difficulties or significant strategic threats, their boards will look for an experienced outsider to help turn things around. These situations sometimes occur because the board has failed to anticipate their outgoing CEO's limits, as discussed in question 5.

11. Should we engage an executive search firm?

Executive search firms can be very helpful in identifying high quality candidates. Boards need to take care, however, not to overly rely upon these firms. The board is ultimately accountable for the CEO selection process and should not abdicate its decision-making responsibility.

When deciding whether or not to engage the services of a search firm, there are a number of factors that boards and search committees should consider:

- **Is there a strong, agreed-upon internal successor?**
  If the organization has an effective succession planning process in place and the CEO transition is occurring as a planned event, there may be a strong, prepared internal candidate who has management and board support. In such a situation, there may be little need to engage an executive search firm.
- **If not, how deep and strong is our internal pool of candidates?**
  In situations when the CEO transition has not been anticipated or planned, an external search may not be necessary if the organization has strong "bench strength" among its senior officers. The board or search committee may, however, seek the assistance of a search firm or management consultant to help objectively assess these candidates.

9 See "CEO Succession 2005" above.

- **If we believe we need an external candidate, how intimately do we know the pool of potential external candidates?**
  In some industries, because of their size or dynamics, directors will be aware of the potential external candidates and have a preferred choice among them, relative to their CEO Leadership Profile. In these situations, the board may choose to handle the selection process on its own, or use a search firm to act as an intermediary. If, however, directors do not feel they have a good handle on the external candidate pool, an executive search firm may provide valuable assistance in helping to source candidates.
- **How will the use of an external search firm be viewed?**
  The use of an external search firm can convey a tone of objectivity and thoroughness to both the organization and its investors.

Boards or search committees that decide that it would be beneficial to engage an executive search firm should interview several firms to ensure they find the one that provides the right fit between the firm and the organization. Directors should be sure to select a search firm that knows—or will take the time to learn—the industry, business, strategy, culture and CEO Leadership Profile.

In developing the contract with the search firm, it is important to "frame" the roles of the board/search committee and the search firm. Directors should be explicit about expectations of the search firm in terms of process, communication, timeframes, decision-making framework and fees. A contract whose terms clearly articulate the board's or search committee's expectations helps establish a tone of "partnership" between the board or search committee and the search firm, and also helps the board or search committee remain in control of the search process and its outcomes.

If there is a point at which relationships between boards or search committees and executive search firms are most likely to become strained, it is usually after the search firm presents its first group of potential candidates to the board. That is because this is often the first point at which both parties realize they are not in agreement as to what constitutes a viable candidate. Such a disagreement usually occurs because not enough time had been invested in working with the search firm on a thorough profile of the ideal CEO. Taking the time to carefully calibrate the CEO Leadership Profile without rushing into the front-end of the selection process is usually the key to a successful, less time consuming succession.

12. How should we involve the CEO and management in the selection process?

The best way to involve management in the selection of the new CEO depends in large part on the particular circumstances that exist at the time of the CEO transition. A CEO succession creates unique dynamics within an organization, especially among the senior management team. The board and/or its search committee needs to understand those dynamics and also ensure that involving members of management in the selection process is not done in a way that disrupts normal business operations or creates undue distractions.

If the succession is planned (e.g. normal CEO retirement), the creation of an effective partnership between the board or search committee and the outgoing CEO during a succession may help ease tensions or anxieties that can arise because of a transition to new leadership. The outgoing CEO can often provide useful input to the CEO Leadership Profile and may also be able to help in identifying both internal and external candidates. There may also be a role for the outgoing CEO in helping to manage the expectations of the internal candidates and in supporting the board or search committee in communicating information about the search process to the organization.

Boards and search committees may also benefit from engaging other senior members of management in the search process. Regardless of whether or not there are internal candidates being considered, members of senior management can provide useful insights and input to the CEO Leadership Profile, which may help the board clarify its own thinking. Involving members of senior management in the search helps the board gauge whether management shares the board's sense of strategic imperatives and priorities and its sense of urgency to achieve particular results, as well as the readiness and willingness of the members of management to accept new leadership.

The organization's top human resources executive may also be a useful resource for the board or search committee. These executives can provide input about individual candidates and also serve as the board's "finger on the pulse" of the organization in terms of its reaction to the selection process and the potential CEO candidates.

13. How do we minimize the risk of picking the wrong candidate?

All business decisions have an element of risk associated with them. When selecting a new CEO, boards and search committees need to be sure they understand, manage and mitigate the risk of making a poor selection decision. There are a variety of process steps and tools to help do this.

- **CEO Leadership Profile**
  This is a useful tool—provided it is used. Even when they diligently define their "ideal" profile, there is a risk that directors will not "anchor" onto this profile during the candidate screening, interviewing and decision-making processes and will instead revert to more subjective, intuitive decision-making. This may occur if the CEO Leadership Profile is overly complex or cumbersome. To help mitigate this risk, directors should simplify their profile into a prioritized list of competencies and attributes that will serve as a useful, streamlined tool for screening and comparing candidates. Directors may assign ratings to various candidates on each element of the profile, or rank candidates using the dimensions of the profile as a guide.
- **CEO Compensation**
  Compensation is an effective way to screen out candidates who may be desirable, but are out of reach financially. Early in the selection process, therefore, directors should define their philosophy for CEO compensation and the compensation range the organization can afford to pay. Typically, boards rely on independent compensation consultants for advice on the competitiveness of the organization's CEO compensation package, including advice on issues such as deferred compensation, which is increasingly a component of CEO salaries.
- **Efficient Scheduling**
  An efficient, well-planned and scheduled selection process in which directors participate fully and effectively helps mitigate the risk of selecting an inappropriate candidate. This can be a challenge, however, since the process of selecting a new CEO is frequently time-consuming, especially when it involves external candidates. It is especially important that the interview stage be well managed, because this is the point at which the entire process can become bogged down because of schedule conflicts between directors and candidates. Of greater concern is the loss of effectiveness that results when individual directors are either unavailable for interviews or participate by telephone. To decrease the risk of making a poor decision, there should be a consistency in both the interview team and interview process. As the short list of candidates to be interviewed is being established, directors should set aside blocks of time to be available for candidate interviews and review meetings.
- **Robust First Interviews**
  Solid candidate interviews built around asking probing questions that obtain informative, relevant answers better enable directors to identify the best candidate. Many directors, however, may not be effective interviewers, particularly if they have either limited or dated experience in interviewing senior candidates. To improve the quality of their interviews, directors should develop a common set of questions for all candidates that will provide information about each element of the profile. It is also useful to ask behavioral questions because they force the candidates to base their responses on facts and limit the possibility that articulate candidates will impress directors with style over substance. Interviews are best done in smaller teams of two or three individuals, with each team covering specific areas of the profile. The use of several smaller interview teams helps ensure that comprehensive, comparable data is gathered about each candidate in an efficient, organized and professional manner.
- **Face-to-Face Debriefing**
  People's perceptions differ, and when interview teams are used to gather information on different topics, each team may also have different opinions of the candidate. It is important that the directors hold post-interview debriefing sessions to review their insights and perceptions of each candidate when the interview is still fresh in their minds. These sessions should be done face-to-face so directors can observe, assess and calibrate each other's reactions to the candidates. Through these sessions, directors should rank each candidate and identify the issues, questions and concerns that will serve as the basis for the second round of interviews with the top two or three candidates.
- **Targeted Second Interviews**
  Second interviews provide directors with the opportunity to probe more deeply into the values, beliefs, operating style and judgment

of finalist candidates. Once again, investing the time to prepare questions in advance and plan an efficient interview schedule will help ensure the effectiveness of these interviews.

- **Meetings with Management**
  Asking finalist external candidates to meet with members of management may be an appropriate and desirable way to learn how well they will fit into the organization. The board should exercise care both in framing these meetings between management and the candidates and in later debriefing management members. It is important that members of management understand that they are not "picking their boss," but are providing input about how well the candidates would fit the organization. Insights from management can be useful to the board when making its final decision and involving members of management in the process can help smooth the integration of the new CEO into the organization.

- **Full Board Interviews**
  Boards that create search committees to lead the CEO selection activities should decide how and when the full board will become involved in the process. Some boards are comfortable meeting a single finalist candidate; others want to see two or three finalist candidates. The full board's meeting with candidates brings another perspective to the process, thereby helping ensure the most appropriate candidate is selected. To be effective, however, these interviews need to be managed carefully so both directors and candidates understand the interviews' purpose and value. To help the board prepare for its meeting with the candidates, the search committee should provide their fellow directors with a comprehensive briefing that alerts them to any areas of question or concern that the committee may have about each candidate.

- **Reference/Background Checking**
  Reference and background checks provide valuable information, yet are too often an afterthought for many boards or search committees. The board or its search committee should agree on a process for gathering and checking references for finalist candidates. Investing time in advance to generate a list of thoughtful, pertinent questions to ask each reference will significantly enhance the value of these conversations. For example, questions may probe areas that were identified as key priorities in the CEO profile or focus on the candidate's "softer" skills, such as their ability to work effectively with the wide range of stakeholders with whom a CEO must interact. Boards may choose to engage an independent third-party to objectively gather background information (i.e. prior criminal/regulatory issues, etc.). Directors should also identify individuals in their own networks who may provide useful insights about candidates.

- **Board Recommendation**
  Once the search committee has agreed on a candidate, it needs to make its recommendation to the full board. In addition to the recommendation itself, the search committee should also outline the key areas the board needs to focus on in making the offer to the individual and integrating the new CEO into the organization.

14. Who can help us reduce the risk inherent in CEO succession decisions?

Selecting a CEO is an important, but hardly everyday occurrence and it isn't uncommon to find directors sitting on their first search committee. The process steps, interview tools and use of executive search firms described above will all help guide directors through the search process and help mitigate their risk of choosing an inappropriate candidate. Directors can further reduce their risks through the use of professional advisors. To get the full benefit of these advisors' services, including their assistance in reducing risks in the CEO selection process, the board or its search committee should identify and engage its advisors early in the process. It is essential that boards engage these advisors independently and that the board retain responsibility for making final decisions about the CEO.

- **Compensation Consultants.**
  CEO compensation is complex and is an area of board responsibility that is evolving very rapidly. To help them in carrying out this responsibility, many boards obtain professional advice from compensation consultants to develop a competitive compensation philosophy and pay range as an early step in their search process. Compensation consultants can also assist the board in negotiating and creatively structuring an attractive compensation package with the finalist candidate. Many boards have pre-existing relationships with a compensation consultant through their Compensation or Human Resource Committee.
- **Management Psychologists**
  Management psychologists can provide boards and search committees with objective, third-party input about their finalist candidates on critical issues such as the candidates' leadership style, interpersonal approach and overall cultural fit. They may also help identify gaps between a candidate and the CEO leadership profile and help alert boards to issues which must be addressed in order to successfully integrate the new CEO into the organization.
- **Legal Advisors**
  Legal advisors should be consulted to assist the board in developing a CEO employment contract. Involving a legal advisor early in the search process will help the board determine elements of the contract that are fixed and those which may be negotiable (eg. city of residence, change of control provisions, etc.). Understanding the negotiable and non-negotiable elements of the employment contract can help in setting expectations with candidates when these issues arise during the interview process.

15. What should our CEO selection communications plan look like?

Typically, the selection of a new CEO is a material event that often attracts considerable curiosity and scrutiny, and may create instability with various stakeholders, including employees, customers and investors. Ideally, boards would manage these pressures by moving quickly with an open and transparent search process. Instead, however, the time required to conduct a rigorous search and the need to maintain confidentiality during the search process often results in boards behaving in a more tight-lipped fashion.

A well planned and executed communications plan can help mitigate stakeholders' concerns during the CEO selection process. At the onset of the process, therefore, boards should identify the organization's key stakeholders and their main concerns, as well as what should be communicated to each of them, by whom and in what timeframe. The board will need to periodically refine its communication plan during the selection process to keep each stakeholder group appropriately updated about the selection process and its progress. It is also prudent for boards and search committees to obtain the assistance of their legal advisors to ensure that they understand and fulfill their legal disclosure obligations related to the CEO selection process.

AVOIDING COMMON CEO SUCCESSION MISTAKES

There are some common pitfalls to avoid in the CEO succession process. These areas are often neglected or overlooked by directors, which will detract from the success and effectiveness of CEO transitions.

- ***Starting the process based on untested assumptions about the requirements of the role:*** The key criterion for a successful CEO succession is that it must be a strategy-led process. Boards must start with a careful analysis of the organization's strategy and the type of leadership required to execute that strategy successfully. Boards should pay particular attention to the challenges and obstacles the organization is likely to encounter in executing its strategy. Failing to take the time to build a CEO profile that is based on an understanding of the business and the organization's needs will lead to problems later in the selection process.
- ***Over-reliance on the CEO's assessment of internal talent:*** Boards must get first-hand knowledge of the internal talent. CEOs may provide input to the board, and will have their own opinions about various internal candidates. There is a natural tendency, however, for CEOs to replicate themselves and their style in the succession process, which can be particularly problematic if a significant change in strategy or culture is required.
- ***Over-reliance on the executive search firm:*** The entire board should seek out information about candidates through trusted contacts or from direct experience to add to the objectivity of the selection process. A search firm can be an invaluable partner, especially with an external search, but boards must always remember that the ultimate responsibility for the choice of the CEO rests with them.
- ***Over-emphasis on expediency:*** A CEO succession is likely the most important decision directors face. It is crucial that directors establish a robust process and then devote the time to carry out the process fully and effectively.
- ***Not dealing with CEO performance issues directly or quickly enough:*** Ensuring that an ongoing process exists for assessing the CEO's performance will help prevent a situation that requires the emergency succession of an existing CEO. A thorough performance management process allows the board to better anticipate when the current CEO's abilities may be inadequate for the organization's needs. Holding regular, explicit conversations about the CEO's expected tenure also allows for better long-term CEO transition planning.

The Board's Role in Ensuring the New CEO's Success

There is no perfect candidate for a role as complex and multi-faceted as CEO. Because of that, the board's role does not end once a new CEO has been selected—in fact, in many ways, that is when the board's real job begins. The failure rate of new CEOs is not solely due to the wrong candidate being selected for the job. In many instances, CEOs who have failed did so because they were poorly integrated into the organization. The board has a key role to play in helping to ensure the successful integration of a new CEO. Other key players who also share a responsibility and accountability for the CEO's integration include the senior human resources executive and, of course, the new CEO.

16. How do we successfully integrate the new CEO into our organization?

Once the board has selected a new CEO, directors must turn their focus to helping ensure that the individual will be a success in the role. A director—typically the chair—should take responsibility for overseeing the new CEO's integration into the organization.

The board should focus on five factors that research indicates are critical to the successful integration of new executive talent. These issues are important to address for both internal and external hires, though certain factors will require more attention with an external hire, who will need more help to develop an understanding of the organization and its culture, and in developing relationships with its key stakeholders.

- **Learning and mentoring: Foster the CEO's accelerated learning**

  A good CEO will interact with directors from the start to obtain their perspectives on the organization, its industry and his or her own leadership. If a new CEO's excess of ego or lack of confidence prevents him or her from engaging the board effectively, this is clearly the first issue for the board to address as part of the CEO's integration.
  The selection process will have identified gaps that exist between the CEO's knowledge or

skill set and the needs of the organization. The chair and the senior human resource executive should identify resources, including coaching from directors, to help the CEO bridge those gaps.

- **Role clarity: clarify expectations from the very start.** There are three key issues to address in order to clarify the CEO's role and expectations:

    a. *Establish measures of success*: People are more likely to succeed when they clearly understand the expectations set for them. The board should ensure that both the qualitative (behaviors) and the quantitative (objectives and deliverables) measures that constitute the CEO's performance expectations are clearly articulated from the very start.

    b. *Deliverables:* The board or its Human Resources/Compensation Committee should work with the CEO to translate the measures of success into a set of objective deliverables that will form the basis for the annual CEO performance review. Setting clear, agreed upon deliverables early on greatly facilitates the evaluation process down the road.

    c. *Scope:* The board should take the initiative in setting explicit boundaries to define those areas that are the responsibility of the board, and those that fall under management's authority. (It should be noted that this division of responsibilities will vary from one organization to another, depending upon the circumstances and individuals involved.)

- **Relationships: help the CEO establish the right relationships with the organization's stakeholders**

    This is particularly important if the CEO is an external candidate, especially if he or she comes from another industry. The board should help the CEO identify the organization's key stakeholders and provide him or her with any insights the board has developed regarding each stakeholder or stakeholder group. The outgoing CEO may help in transferring key relationships to the new CEO.

- **Culture: help the new CEO understand and successfully navigate the organization's culture**

    The board can help accelerate the integration of a new CEO, especially if he or she is an external candidate, by providing him or her with a good understanding of the organization's culture. This should begin during the interview stage, since it should be a key criterion used to assess the candidate's fit with the organization.

    In situations where the organization is undergoing a strategic change, it is important that the CEO understand the organization's culture, but not be co-opted by it. The CEO should first assess the culture and whether it is aligned with the organization's strategic needs before deciding whether or not to adopt that culture.

- **Success: identify an early win**

    A new CEO's integration into an organization is greatly facilitated by the success of an early win. The board should be proactive in helping the new CEO identify key issues that he or she should deal with early on in his or her tenure that would help build credibility with the organization.

Finally, what role, if any, should the outgoing CEO play in the integration of the new CEO? In a planned transition, there is often little for the former CEO to do and it is best that they leave the organization and the board immediately.

An outgoing CEO may stay on for an interim period in a consulting role or as a director, however, if there is a compelling rationale to do so (e.g. because of his or her critical business knowledge or contacts that need to be transitioned, etc.). In these situations, the roles of the outgoing and incoming CEOs must be clearly defined and communicated to prevent confusion between the individuals and within the organization. It is also important that the personalities of the two individuals be such that the dynamic between them will be a constructive one. One final consideration: having the outgoing CEO remain with the organization will only be beneficial if there is a continuity in strategy. If the new CEO has a change mandate, it will be almost impossible to implement his or her agenda with the outgoing CEO still in the organization.

17. How do we track how well the new CEO is integrating?

The integration of a new CEO usually takes longer than most organizations expect—typically a CEO will not fully meet the integration criteria before an entire 12-month business cycle has been completed.

There are four factors for boards to watch which will help directors get a quick read on how successfully the new CEO is integrating. In mid- to large-sized organizations, the senior human resource executive should play a key role in supporting the board chair by putting a system in place to track the new CEO's progress.

Acceptance

Boards should monitor how well the new CEO is gaining acceptance from the organization's key stakeholders. It is important to pay attention to the early reaction to the CEO's style. If necessary, the board (or the senior human resources executive) should coach or advise the CEO on ways to adjust his or her behavior so it is more consistent with the organization's culture. Boards should be aware that early perceptions can take on a life of their own. Therefore, it is best to help the CEO address any situations that may possibly derail his or her acceptance by the organization as soon as possible.

Alignment

How well aligned are the CEO, the board and the management team with regard to the organization's strategy? Disagreements about strategy are the most common reason for early CEO departures.

Credibility

Beyond being accepted by the organization's key stakeholders, new CEOs must also develop credibility with stakeholders if he or she is to be successful in the role. Boards should monitor how well the CEO is developing credibility with both key stakeholders and other constituent groups.

Contribution

When the CEO was hired, the board should have set out explicit expectations for him or her with regard to the role. Boards should monitor the CEO's performance against those expectations to determine whether or not the CEO is making the contribution to the organization that was expected when he or she was hired.

Executive or *in camera* sessions (meetings of directors without management present) are good forums for directors to review the CEO's progress in the four areas of acceptance, alignment, credibility and contribution. It is important to begin monitoring the CEO's performance in these areas as soon as he or she is hired so the board has time to address any issues or concerns as soon as they arise and before they become entrenched.

Sometimes, through its monitoring of the CEO's performance, it becomes apparent to a board that the new CEO is not working out and will need to be replaced early in his or her tenure. In these situations, the board must develop and implement a communication plan to explain the situation to the organization and its stakeholders. This plan should emphasize the actions the board is taking to ensure the stability and continuity of the organization and its strategic direction. From a succession perspective, this situation should be treated as a sudden or unplanned CEO vacancy and the board will need to immediately restart its CEO selection process.

18. What is our role in coaching and developing the CEO?

The high failure rate of CEOs is well documented. New CEOs fail for many reasons, but they rarely do so for reasons which are theirs alone. Much of the responsibility for a CEO's failure lies with boards that do a poor job in actively coaching and developing their CEO. By following a few basic practices, however, boards can greatly enhance their effectiveness in carrying out these responsibilities.

The board must lay the necessary building blocks during the CEO selection process to provide it with a good understanding of the CEO's strengths, limitations and performance as well as the organization's strategic and competitive environment.

Each board meeting should include executive or *in-camera* sessions, a portion of which may be dedicated to gathering pertinent data from the directors about their perception of the CEO's performance, including areas in which it excels or may fall short, and what coaching points should be brought to the CEO's attention. During these sessions, directors should also regularly discuss the anticipated length of the CEO's tenure to ensure that the board has time to properly prepare for the succession process. These executive sessions are not meant to be a formal process; instead, they should be an exchange of views among directors regarding the conduct of the meeting and the performance of the CEO and the management team.

Another recommended practice is for the board to assign the accountability for coaching the CEO to a specific director, typically the board chair and/or the chair of the board's Human Resource Committee. Other directors may, however, provide coaching support in specific areas related to their skills, such as experience in a specific geography, handling significant transactions, etc. Certain topics should be on the coaching agenda at all times, such as the CEO's role in developing his or her direct reports, with particular attention being paid to potential successors.

Most boards conduct annual CEO performance reviews. It is not yet a common practice, however, for boards to hold ongoing discussions with their CEO about his or her development, although this is one of the most important roles a board can play in mentoring a CEO. Successful development coaching discussions with the CEO depend upon the board having enough diversity among its members for it to have sufficient expertise to provide coaching on any significant issue the CEO is likely to encounter.

The board's mentoring and coaching of the CEO is particularly important in the first year of a new CEO's tenure. It is incumbent upon the board to create a climate in which the CEO feels comfortable seeking the board's advice on issues and receiving its coaching when required. Much of this advice and coaching can be accomplished in regular board and committee meetings, but there may be times when one-on-one discussions are required. It is important, however, that the content of those one-on-one discussions be shared back with the board at its next executive or *in-camera* session.

Finally, it is important that the timing of succession for the CEO and the chairman roles do not coincide. Most organizations would find it very challenging to transition both senior leadership roles at the same time. With careful, longer-term succession planning for both roles, however, the organization should be able to prevent simultaneous successions.

Special CEO Selection Circumstances

The CEO succession planning issues and processes described above should enable boards to effectively oversee the development of their organization's talent pipeline and conduct an informed, well-managed CEO selection process. There are, however, two circumstances that deserve special attention.

19. What should we do when faced with a sudden, unexpected CEO vacancy?

No matter how diligently a board prepares for a CEO transition, unanticipated situations may still arise, such as changes in a CEO's health or personal circumstances, that may trigger an unexpected departure. These situations are challenging but, depending on the specific circumstances of both the departure and the organization, the board may have several options available to help it manage the process.

If the board has a CEO candidate it has been grooming, but who is not quite ready to take over the position, it may be tempted to search for an external candidate who has all of the required attributes for the role. As discussed earlier, however, externally recruited CEOs have a high failure rate. If the internal candidate is almost ready for the CEO role, the better choice for the board may be to offer the CEO's position to that internal candidate, with an increased involvement by the board in the CEO's integration for at least the first full annual cycle. This approach sends a message of stability to the organization and its stakeholders and limits the length of time that the organization is without a CEO at the helm.

If the internal candidate is clearly one or two years away from being ready to take on the role of CEO, one option available to the board is to have a director act as CEO in an interim capacity, with increased focus on delegating roles and responsibilities to the possible successor to accelerate his or her development. Another choice, depending on the organization's size and complexity, is to hire an interim executive as CEO.

If there are no internal candidates and an external search is therefore a necessity, the board must take action to ensure the stability of the organization's leadership so the organization maintains momentum and the CEO search can be conducted effectively. The worst scenario is to rush the selection process and hire a candidate without conducting the proper due diligence. To provide stability at the top, the board may choose to appoint a director, a member of management, or an external temporary hire to act as interim CEO.

In any of these situations, it is critical for boards to obtain professional advice to help manage communications to internal and external stakeholders. While communication is important to maintain stakeholder confidence during any CEO succession, it is especially so when the transition is an unexpected one.

20. How do we deal with CEO succession in family-controlled companies?

In family-owned businesses, the succession of a CEO is a complex matter involving many business, financial and emotional decisions. Unfortunately, family-owned businesses are often unsuccessful in managing this process. Only about one-third of family-owned businesses survive to the second generation, and even fewer make it to the third generation. The primary reason these business fail is because they did not plan for succession.

All of the succession issues, principles and processes discussed above are valid for directors of family-controlled businesses, though they will also face some added complexities as described below.

First, it is essential to assess whether the board of directors acts as a true board. If the board is too closely connected to the family/company owners to provide objective and independent advice, then it will be unlikely to play an optimal role in the CEO selection process. Directors of companies with a loosely structured governance model, and whose role is more as advisors than true directors, will probably not be able to assume the objective, independent role required to manage a CEO selection process. In these situations, boards need to be explicit about the selection decision-making process, the degree of objectivity in the process and the implications this will have on both the selection outcome and how that decision will be accepted.

Second, employees and external stakeholders usually closely associate the owner-founder with the company and attribute the company's success to that person's active involvement in the business. Therefore, to better ensure a smooth CEO succession, directors must urge the owner to begin succession planning earlier in a family-owned business than would usually be the case in a non-family enterprise.

Third, the credibility of the incoming CEO is a particularly important factor when the baton is being passed to a family member. Successors often face the perception that nepotism is the only reason for their appointment. To counter this, potential successors may choose to first prove themselves in other organizations, or they may be given opportunities within the company to fully demonstrate the extent of their abilities.

Finally, the succession of a CEO in a family-owned business always involves additional emotional complexities and family-related issues. The reason why many owners are reluctant to engage in formal succession planning is precisely because it forces them to confront their own retirement and departure from the business. The two most important contributions directors can make to family-owned businesses are to insist on a long-term succession plan that is discussed and updated regularly, and to help the family find counselors or advisors to deal with the family-related issues if required.

Appendix A: CEO Succession / Key Roles and Responsibilities

CEO Succession: Key roles and responsibilities

This list is not meant to be exhaustive, but it should serve as a good starting point to determine how to allocate the tasks associated with the succession process. This list can vary greatly depending on individual director skills sets and the size of the organization.

Role	Responsibility	Comments
Chair	• Setting annual performance objectives and conducting an annual performance review with the CEO, including a discussion on the timing of the CEO's departure • Coaching the CEO • Ensuring that the CEO is conducting a robust process of succession planning which is appropriately reviewed by the board • Ensuring there is an agreed upon succession process • Setting up the selection committee • Keeping the full board apprised of the succession process as it progresses • Ensuring that the board is responsible for the process and does not overly rely on the CEO or the search firm	• It is customary for the chair to participate on the selection committee, but it can be chaired by another director • Some of these responsibilities may be delegated to the board's Human Resources / Compensation Committee
Board	• Approving the candidate as recommended by the selection committee	• In smaller organizations, the board can also act as the selection committee
Director	• Awareness of the organization's strategy and competitive environment • Knowledge of the universe of possible successors, inside and outside the organization • Knowledge of the current CEO's strengths, limitations, performance	

Role	Responsibility	Comments
CEO	• Keeping the board informed of his/her plans with regard to retirement/tenure in order to ensure a smooth transition process • Overseeing the internal succession planning process to help ensure there are possible internal successors • Grooming and coaching possible successors • Helping to establish the profile for the next CEO • Participating in the successful integration of the successful candidate	• In smaller organizations, the CEO may play a more active role in the process, provided that the board maintains the final responsibility • In certain cases, it is not desirable for the CEO to stay on and participate in the integration of the successful candidate
Selection committee	• Establishing the profile for the successful CEO • Interviewing short-listed candidates against the profile • Submitting a recommendation to the board as to the preferred candidate	
Senior HR executive	• Ensuring there is a robust program for selecting and developing possible CEO successors into the organization • Contributing to the profile for the next CEO • Helping to source external advisers to the process – search firm, compensation consultant, management psychologist	

Appendix B:
CEO Profile of Success Model[10]

Three areas need to be addressed in developing a profile for CEO succession, which are described below. An example is provided in Appendix C.

Organizational imperatives are actions that the organization must take to successfully implement its strategy and reach its objectives.
Questions directors should ask include:

- What are the key challenges facing our organization?
- What must our organization do to accomplish its objectives?

CEO success factors are the leadership requirements for success.
Questions directors should ask include:

- What are the leadership needs of our organization?
- What must our CEO be able to do extremely well in order for our organization to achieve its goals?

Behavioral requirements are the capabilities and qualities necessary to achieve the success factors.
Questions directors should ask include:

- What specific characteristics must the CEO possess in order to achieve the success factors?
- What qualities are necessary, culturally, to lead our organization forward?

10 "Reflections on Fit: Improving Executive Selection", Executive Insights, Volume 14, no. 1, RHR International.

Appendix C:
Sample CEO Leadership Profile

This example of a CEO profile links the organization's strategy with the corresponding characteristics that a successful candidate would need to demonstrate in order to successfully navigate the organization through that strategy. As such, it focuses on the candidate's competencies and behaviors rather than their track record or work experience.

LEADERSHIP PROFILE
CHIEF EXECUTIVE OFFICER

I. Overview

In the early stages of ABC Company's life as a corporate entity, it had to rely heavily upon the leadership in each of the business units. The company is now going through a robust period of improvement, development and integration. Plans are in place for the company to realize its potential as the dominant player in each market segment through innovation and continuous improvement. The immediate requirement is for a relentless focus on execution.

ABC Company was created to "take good companies and make them great companies." To realize this commitment and be recognized as a top quartile performer, it must achieve sustained levels of financial results and a persistent emphasis on innovation in meeting customer needs. The value proposition of ABC Company requires that the company realize the value of each business unit and capitalize on the leadership capability within those business units. It will continue its efforts to integrate the companies it has acquired into the two current lines of business in the areas of systems, processes, and cultures. It will also continue its focus on quality, customer service and leadership development. At this stage in the life of the organization, with plans in place, the focus must be placed on the execution of those plans. While clear measures of success have been achieved in the implementation of several key initiatives, ABC Company will have to successfully integrate the lessons learned from those initiatives into ongoing ways of doing business.

II. Strategic Imperatives

1. Clearly define and communicate a long-term vision for the company that provides focus and direction. This would:
   i. Enable consistent, coherent operating actions.
   ii. Identify and capitalize on appropriate business opportunities.

2. Build a performance-oriented culture.
   i. Implement systems to support individual and organizational accountability, e.g. goal setting, performance review, aligning rewards with performance, and meaningful development plans.
   ii. Focus on execution – set stretch goals and hold each other accountable for accomplishment of objectives.
   iii. Drive the completion of the major initiatives. Focus on a few things – bring things to completion.

3. "Become better before becoming bigger."
    i. Seek modest growth in a flat market while driving cost/capital out of the business. Focus on margins first, top line growth later. Cost efficiency is a priority. Strategies include consolidation, downsizing and moving manufacturing to more cost-effective locations. Balance the concerns for cost containment with a willingness to pursue reasonable growth opportunities.
    ii. Get more efficiency from current assets.
    iii. Develop a track record of performance to elicit greater investor interest.
    iv. Review capital investments.

4. Articulate an organizational philosophy that explains the value of the current organizational structure.
    i. Determine when to operate as separate business units and when to operate as part of a corporation.
    ii. Identify the balance between centralized and decentralized control.
    iii. Define and realize the value proposition of the corporate structure.
    iv. Identify and share best practices.

5. Attract, retain and develop the leadership talent throughout the organization to support the aspirational goals and the operating plans of the company.
    i. Reinforce the notion that leadership talent is a company-wide resource.
    ii. Recognize that leadership development is a critical management responsibility.

6. Drive ABC Company Way through the organization.
    i. Reinforce the notion of one company.
    ii. Increase the identification with ABC Company.
    iii. Celebrate and reward behavior consistent with the ABC Way.
    iv. Integrate the cultures and systems of the business units while preserving that which is valuable about each.

7. Foster creativity and innovation internally and actively look for new ideas outside the company. Continually build a fact-based understanding of the forces that will impact the industry structure.
    i. Provoke new ideas.
    ii. Imagine the future.
    iii. Reward thoughtful risk taking.

III. CEO Characteristics Specific to ABC Company

1. *The ability to communicate a clear and compelling vision that gives the entire organization a rallying point and which tells a clear story to external constituents.*

   Able to translate the charge to "take good companies and make them great companies" into both practical and visionary terms. Creates opportunities for people to expand their own vision of how to contribute to the company's future. Represents the company effectively with the investment community. Is a visible presence in the field. Captures the imagination of the board and the leadership team.

2. *The ability to drive the execution of the business plan and to create a sense of mutual accountability throughout the organization.*

   Encourages each layer of management to set goals that are both challenging and realistic. Learns from experiences and incorporates the lessons learned. Demonstrates a sense of urgency. Inspires confidence that they can achieve the stretch goals. Continues to establish a performance-oriented culture.

3. *Ability to create an environment that fosters teamwork.*

   Builds a collaborative leadership team that is committed to the long-term success of the company. Encourages the sharing of best practices and resources across business units. Creates a shared sense of ownership throughout the organization.

4. *Ability to create a plan for positive change and to manage the organization through the change*.

   Understands that organizational change requires sensitivity to history and cultural issues as well as the persistence and courage to challenge the status quo. Communicates the rationale and the plan for change in a way that fosters cooperation and support. Recognizes when to push for change and when to take time to consolidate gains.

5. *Invest personal time and energy in the development of the leadership talent of the organization*.

   Conveys a positive example of professional development and encourages others in the organization to manage their own careers. Actively manages the development of the top 200 managers in the company. Is actively involved with and is a visible sponsor of the leadership development effort.

6. *Create an environment that fosters innovation and creativity.*

   Sets an example of continuous improvement. Is alert to new developments and best practices in all areas of the business and industry in general. Builds a greater awareness of, and desire to learn from, sources external to the company.

7. *Demonstrated track record of success.*

   Has a history of sustained financial performance. Is able to articulate lessons learned from experience. Shows a clear track record of leaving organizations better off for having been there.

8. *Behave in a manner that is consistent with the ABC Company Way.*

   Is seen as authentic in aligning personal values with the corporate values.

IV. CEO Attributes – General

1. **Leadership**
   i. Elicits loyalty and follower-ship
   ii. Keeps the organization energized and focused through tough times
   iii. Persistently drives to set and achieve high standards
   iv. Inspires people to set and pursue stretch goals
   v. Sets a tone of urgency and decisiveness.

2. **Character**
   i. Clearly interested in the greater good of the company
   ii. Demonstrates courage to take a stand on important issues, to do what is right
   iii. Admits mistakes and learns from them
   iv. Makes sound judgments under pressure
   v. Shows consistency between stated values and actual behavior – walks the talk.

3. **Interpersonal Skills**
   i. Relates comfortably to all levels of the organization; makes self accessible
   ii. Conveys compassion and a genuine sense of valuing people
   iii. Sizes up people quickly and accurately
   iv. Makes tough-minded, objective judgments of people
   v. Listens attentively and respectfully
   vi. Communicates in a candid, straightforward manner.

4. **Quality of thinking and decision-making**
   i. Thinks comprehensively and strategically
   ii. Solves complex problems and teaches effective problem-solving skills
   iii. Consistently exercises sound judgment
   iv. Inspires innovative thinking
   v. Has intelligence measured in the superior range
   vi. Balances between conceptual/strategic thinking and a practical perspective
   vii. Instinctively sees where to challenge the status quo.

5. **Management**
    i. Surrounds self with high quality talent
    ii. Monitors performance carefully
    iii. Exercises a strong bias for action
    iv. Communicates desired outcomes clearly
    v. Drives toward results and holds self/others accountable for them
    vi. Defines objectives and keeps the organization focused
    vii. Addresses poor performance in a fair and timely manner.

6. **Business Skills and Experience**
    i. Understands governance in a public company
    ii. Inspires confidence among the investment community
    iii. Builds on a strong operational background; develops a realistic, and practical view of business
    iv. Makes realistic and meaningful commitments to the community
    v. Shows appreciation for the fundamentals.

Where to Find More Information

Canadian Institute of Chartered Accountants publications

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