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How Boards Should Plan for CEO Succession

A Board and executive's guide to planning for CEO succession, developing a CEO leadership profile, and navigating the CEO onboarding process.

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The importance of CEO Succession Planning

An organization cannot function without a CEO, just as a ship cannot sail without a captain. Ships, however, have one saving grace; in cases where the captain becomes incapacitated, their first mate assumes command and guides the ship safely into port.

A captain has a 'succession plan,' so to speak, given their first mate will lead if they are no longer able to. Although captains have known for hundreds of years that a backup plan is essential, even in today's disruptive turbulent market there are still many companies that lack a plan or strategy to handle what will happen if their CEO resigns or is unable to fulfil their duties.

A board without a proper CEO succession plan is failing the company it represents. After all, the board's primary function is to ensure the company's prosperity and continuity, defending the interests of both its shareholders and stakeholders.

CEO succession planning is an essential component to the survival and sustainable growth of any business, as is succession planning among executive management teams. It is a fundamental tool for organizations to deliver continued effective performance through leadership continuity. Companies' succession plans should identify high-growth individuals, train them, and direct them into their leadership pipeline.

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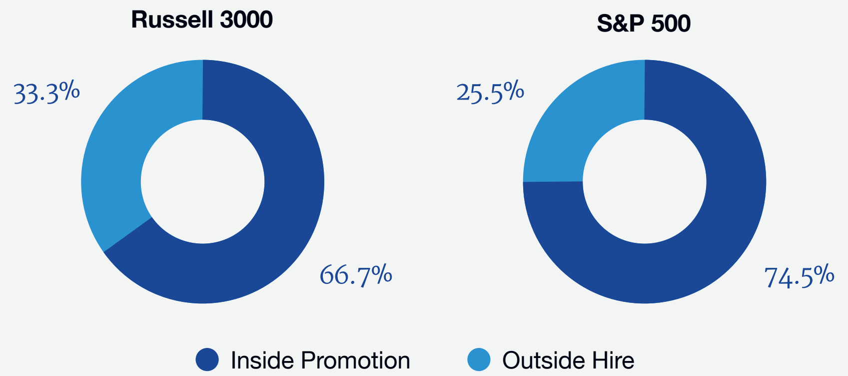
CEO Succession Market Practices

In 2021, Harvard Law School released its annual report on CEO succession. It was titled CEO Succession Practices in the Russell 3000 and S&P 500: 2021 Edition. It delved into CEO succession placement types and whether the respondent CEOs were promoted internally or hired externally.

Placement Type, by Index (2020)

(Percent of total)



*Source: ESGAUGE/The Conference Board, 2021

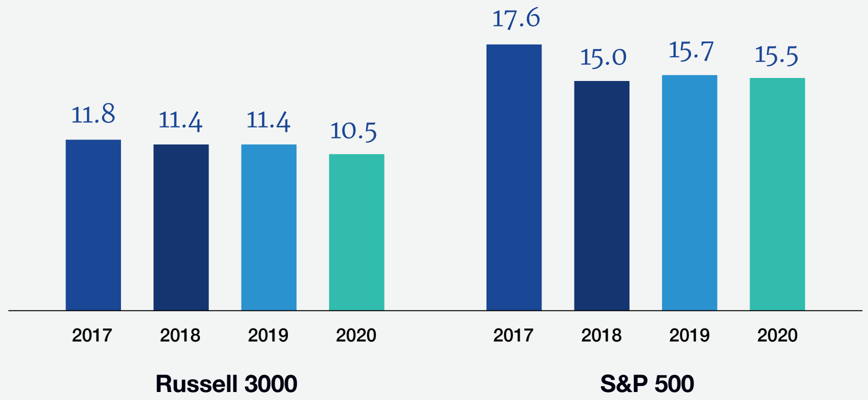
Figure 1.

Of the incoming CEOs in the Russell 3000, 33.3 percent were outsiders, while 66.7 percent were insiders. The numbers were lower in the S&P 500, where outsiders represented 25.5 percent of all successions, compared to 74.5 percent of insiders (as shown in figure 1).

The data shows that the companies listed in these indices prefer internal successors. It is no surprise, either. Internal successors are great for company morale and understand the unique risks and opportunities faced by the organization. The catch, however, is that you need to develop solid talent development pipelines if you want to rely on an internal successor. Consequently, a succession plan is the first step toward developing talent for the CEO role.

Tenure-In-Company of Inside CEO Appointments, Average by Index (2017-2020)

(Number of Years)

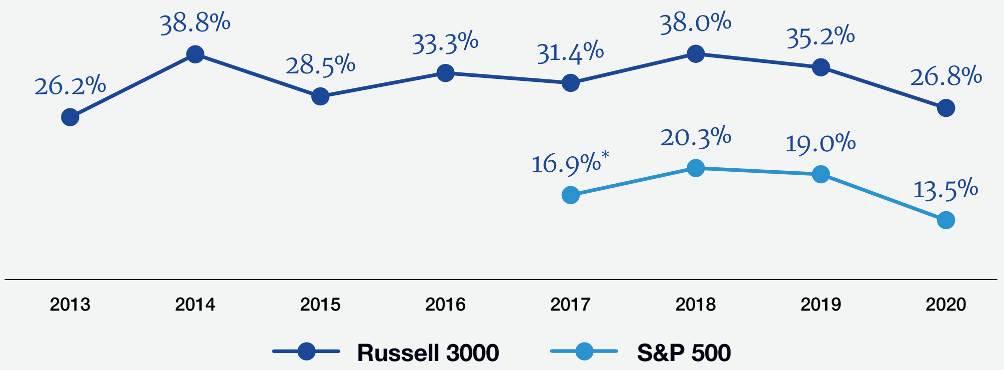


*Source: ESGAUGE/The Conference Board, 2021

Figure 2.

Inside CEO Appointment of Seasoned Executives, by Index (2013-2020)

(Percent of Total)



*Source: ESGAUGE/The Conference Board, 2021

*Data collection from the Russell 3000 started in 2017

Figure 3.

As shown in figure 2, insiders promoted to the CEO role in Russell 3000 companies had an average tenure-in-company of 10.5 years in 2020, with 13.5 percent reporting a “seasoned executive” tenure, meaning a tenure of more than 20 years at the company. This compares with an average tenure-in-company of 15.5 years found in the S&P 500 index (or five years longer than their counterparts at Russell 3000 companies). Of the 2020 insider CEOs, 26.8 percent had a seasoned executive tenure of more than 20 years with the company, as shown in figure 3.

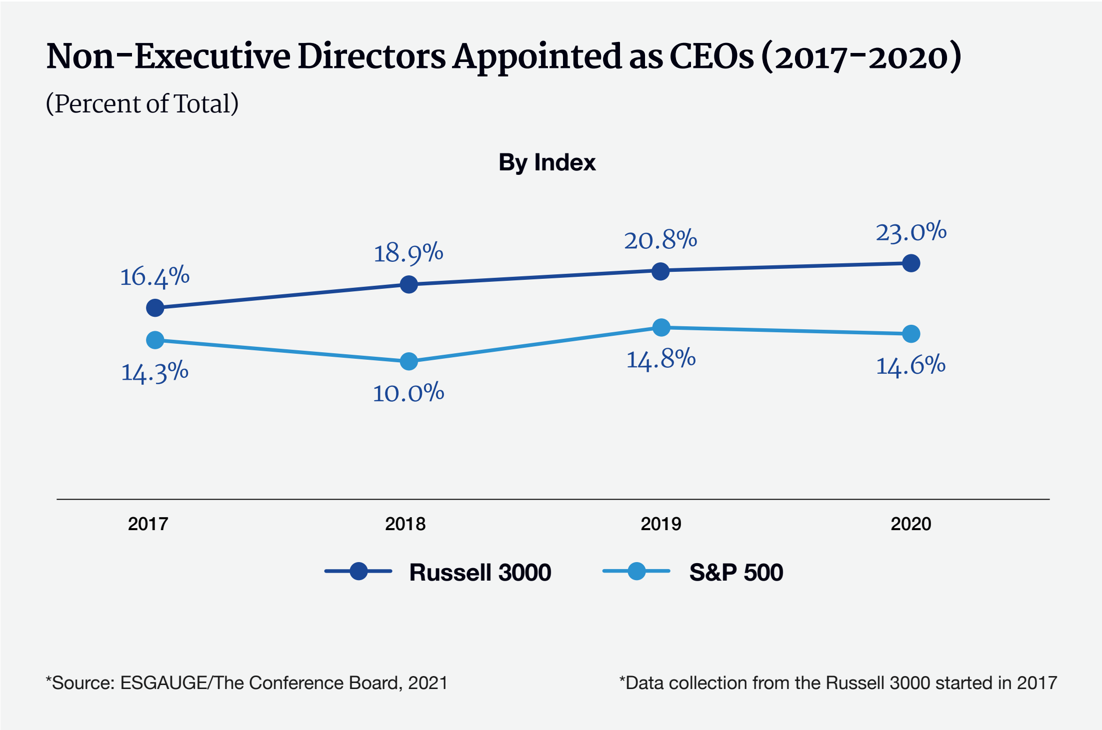


Figure 4.

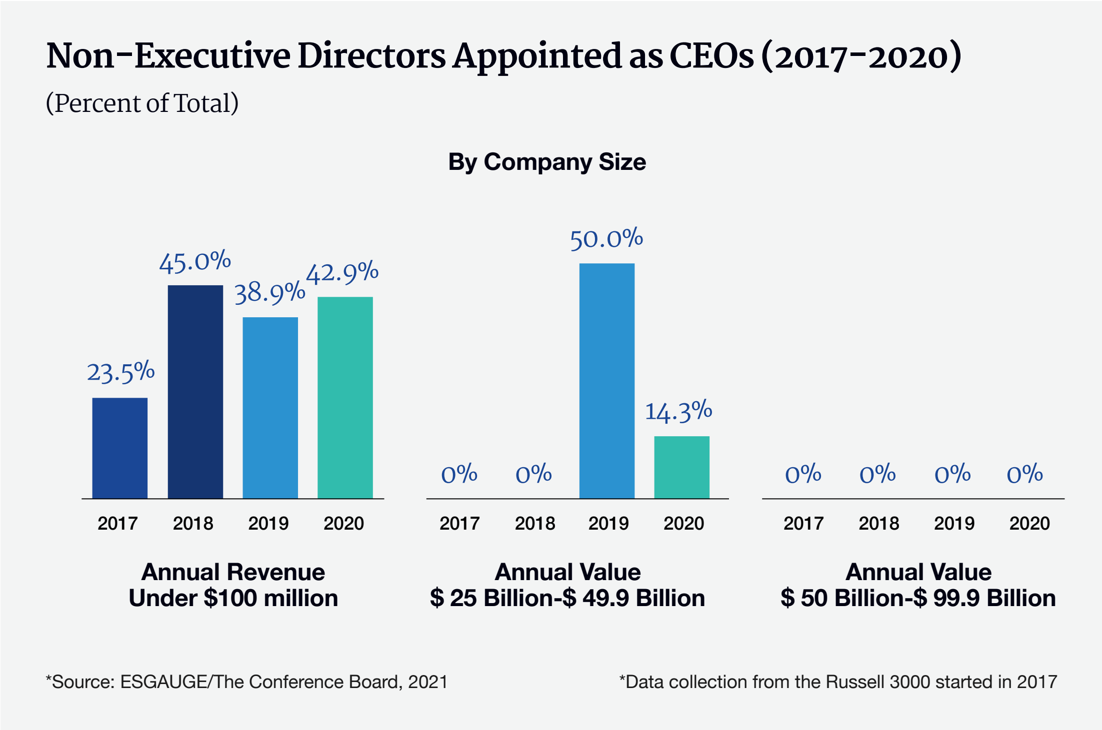


Figure 5.

Companies are increasingly appointing Non-Executive Directors as their CEOs. It is apparent that Non-Executive Directors have become a significant source of CEO talent, representing 23 percent of insider CEO appointments in the Russell 3000 in 2020 as shown in figure 4. Among S&P 500 companies, insider Non-Executive Directors were appointed as CEO in 14.6 percent of cases. The data also revealed that smaller companies were particularly likely to appoint a Non-Executive Director to the position of CEO as shown in figure 5.

While we sincerely hope your CEO has a long and successful tenure as head of the company, 60% of corporate executives leave after just 18 months in their new position.

This alarming statistic can be dramatically improved if companies engage in proper CEO succession planning.

CEO Succession Planning Is a Key Governance Disclosure Standard

Companies should outline their succession planning approach in their annual reporting documents. In doing so, they should clarify their succession planning process's scope, its influencing factors (such as strategy and culture), and its recent and planned developments.

When a company describes its succession planning approach, its stakeholders gain vital insight into the board and leadership's ability to identify and manage potential risks and opportunities.

External parties like governance, proxy, and recruitment advisors are key resources when it comes to succession planning. They can provide advice on succession processes and assess whether companies are taking sufficient steps to deliver sustainable performance to stakeholders. Many regulatory bodies also require disclosures on the Board's and Executive Committee's (ExCom) composition, qualifications, and structure, as well as its policies and processes for CEO succession planning.

Owning the CEO Succession Planning Process

Boards owe it to their companies to recognize the importance of succession planning in providing continuity and sustainability. Not surprisingly, nowadays all public companies have a succession planning policy for the CEO and Executive Management.

Board Nominations Committees and Corporate Governance Committees are responsible for reviewing the company's CEO selection and appointment policy on a regular basis based on the applicable laws, regulations, and Corporate Governance codes. They must also consider various other stakeholders such as proxy advisors, shareholders, and institutional investors.

An organization's succession policy should create a framework to ensure the smooth replacement of the CEO. It should also outline the process for selecting qualified successors who are compatible with the company's strategy and objectives. Furthermore, it needs to support the organization's diversity and inclusion objectives, while still ensuring compatibility.

The Board oversees the CEO succession process. Typically, it is led by the Independent Chair of the Board, the Chair of the Nominating Committee, the Chair of the HR Committee, or a Senior Independent Board Member. Regardless of whom the Board selects to lead this important task, they should have previous CEO and HR experience, strong strategic thinking skills, a thorough knowledge of the company and its industry, and experience in succession planning. The Board may also elect a task force to support its decision-making. It usually consists of the Board Secretary, the HR Officer, and the Compliance Officer. Succession task forces should continuously communicate their progress with the Nomination Committee, the Board, and optionally with major shareholders.

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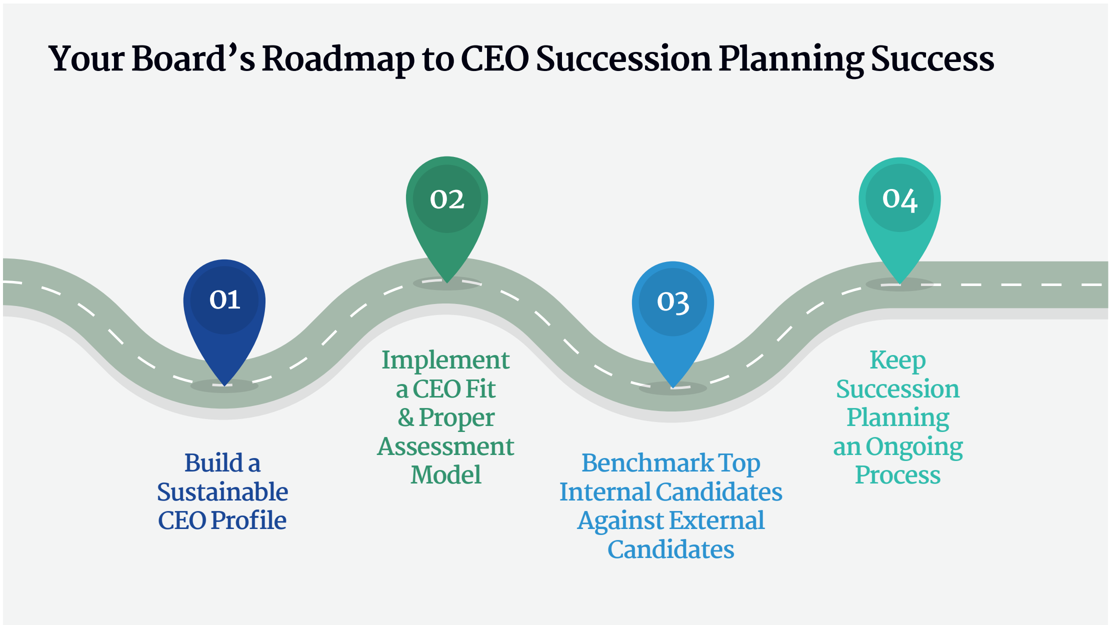
When it is time to appoint a new CEO, the Board should also decide what part the current CEO will play in the process. In making this decision, the Board should consider its existing relationship with the CEO. If an outgoing CEO is not leaving on good terms, it is not a good idea to involve them in the appointment or onboarding of the incoming CEO. Whenever possible, the incoming CEO should have the opportunity to spend time with the outgoing CEO before their final departure. In the event that this is not feasible, the Board will assume this role. Both eventualities, and the processes that follow, should be outlined in the company's onboarding policy. Developing a transition timeline for the new CEO's integration is also a best practice.

Finally, organizations should establish succession plans during times of stability. Doing so affords the Board ample time to identify or define which critical CEO skills and attributes will ensure the company's long-term viability. Once a board is aligned on what the next CEO should look like, it can turn its attention to translating that profile into a pool of qualified future candidates.

How to Establish a Proper CEO Succession Planning Process



Build a Sustainable CEO Profile

A CEO's job is more than making sure the company's day-to-day operations run smoothly. They need to be willing to rethink how their business operates and why it exists. Corporate leaders need to be able to consider a broader perspective.

Companies should do the same. In order to develop the ideal CEO Leadership Profile, the current assessment process should be revisited and compared against the company's vision, mission, values, goals, strategy, governance, and culture. In the same way that any CEO should be equipped with the skills to address the company's short-term issues, they should also have the skills to support its long-term performance. It is therefore important that succession planning is guided by corporate strategies that are sustainable.

Boards should be careful about becoming too idealistic in their expectations when they are creating a CEO Leadership Profile. Some of the common mistakes Boards make include:

- Only considering perfect candidates who have previously worked as CEOs
- Only seeking out candidates of such a high caliber that the company cannot afford to appoint them
- Expecting candidates to be the same as the incumbent CEO and to have the same skills, experience, and qualifications
- Looking for candidates while neglecting the aspiration factor. Organizations need to ask themselves, "Would this candidate agree to take this position?"

For most boards, however, determining a CEO Leadership Profile is not an easy task. A common best practice is for boards to engage external leadership advisors to assist the Nomination Committee in benchmarking and developing the ideal leadership profile.

Implement a CEO Fit & Proper Assessment Model

After determining the leadership profile your CEO needs to succeed, your organization and its Board can begin to develop an assessment framework.

Based on Stanton Chase's Ideal CEO Fit & Proper Assessment Model, the following competencies, skills, and experiences should form part of your assessment criteria:

- General CEO compliance and assurance experience
- Leadership and interpersonal skills at C-Level
- Professional skills and experience in related industries
- Executive Committee & Board leadership experience
- An understanding of the company's purpose and sustainability principles
- A stakeholder-engagement mindset
- The ability and desire to make a long-term commitment
- Sustainable strategic planning competence
- Financial & non-financial performance consistency
- The ability to create a culture that fosters change and engagement strategies
- Resilient and resilience-orientated when in crisis
- The ability to build trust

Benchmark Top Internal Candidates Against External Candidates

Boards should consider eligible internal candidates first. Talent development and proper succession planning throughout a company will boost employee engagement and retention.

Both internal and external candidates should undergo an assessment that compares their experience, skills, and capabilities with the leadership profile previously created. Internal candidates should be assessed along with executive leadership team members (direct reports of the CEO) under the same framework as the CEO effectiveness review. As part of this assessment, their effectiveness, potential for development, and readiness for internal CEO succession should be evaluated. It is recommended that all internal CEO candidates undergo a three-year focused development program prior to their appointment.

Your executive team's CEO readiness status will reveal whether you need to proceed internally or prepare for an external appointment.

It is a good idea to seek out external candidates while evaluating internal candidates. Boards can reduce risk by bringing external candidates in early, as well as creating a solid pool of diverse and skilled candidates.

Where appropriate, Board Directors should also be considered as possible candidates. If there is an immediate need for succession, Directors can also be appointed as interim CEOs until a permanent CEO is named.

Creating a pool of candidates and assessing them can be highly technical and should be handled by a sound independent process.

Organizations should consider using an experienced leadership advisory firm in order to establish a solid pool of candidates, ensure successors' eligibility, implement a tested process for evaluating candidates, and ensure the quality of the assessments being conducted. The use of an external firm can convey a tone of objectivity and thoroughness to both the organization and its investors.

Ensure that Succession Planning is an Ongoing Process

In the aftermath of replacing a CEO, succession planning may be the farthest thing from your mind. Nonetheless, it must be an evergreen process. Maintain a regular dialogue with your Board about talent development and your talent pipeline.

When an organization's Board takes succession planning seriously, its executive leadership will feel more confident about its governance. It will also help them feel more secure about their own career development and prospects within the company. The result is better stakeholder engagement.

Set the New CEO Up for Success

Having a successful onboarding process that involves your board, outgoing CEO, and Chief Human Resources Officer makes a world of difference in whether or not your new CEO succeeds.

Organizations should consider the following when designing onboarding plans for incoming CEOs:

- How much time the incoming CEO will spend with the departing CEO (if any at all)
- Whether the incoming CEO needs to be introduced to key contacts or stakeholders during their onboarding or transition phase
- What the incoming CEO needs to know about the organization's culture and internal politics
- Whether the incoming CEO will need to meet with other executives during their onboarding or transition period to gain a deeper understanding of their roles
- Whether the incoming CEO needs more information regarding the organization's values, goals, or ethics
- What the company's short and longer-term strategic objectives are
- What the company's shareholder commitments and stakeholder engagements are

CEO Succession Planning Is Essential for a Company's Continuity and Sustainability

Every forward-looking organization and Board must have a proper succession plan in place. Effective CEO succession planning is a key element of good governance, and good governance is an important driver of long-term performance and sustainability.

Having a good CEO makes it hard to imagine the future without them or the need for their replacement. In this case, succession planning is a way to ensure their legacy. However, if an organization has a better chance of growth with a new CEO at the wheel, then having a proper succession plan in place will mean you are prepared to undertake their replacement.

As an experienced Board Practitioner, I can confidently recommend that your board is best served by prioritizing CEO and Executive Committee succession planning.

I hope this white paper will help you get started on the road to CEO succession planning success.

Succession Planning with Stanton Chase

Have you developed a plan for identifying and developing your next CEO? Are you having trouble aligning your CEO succession plan with your organization's strategic objectives?

With Stanton Chase's leadership advisors by your side, succession planning does not need to be a daunting or intimidating task.

Click here to learn more about our succession planning services.
Click here to get in touch with one of our consultants.

About the Author

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George Vlachos is an experienced Corporate Governance Professional, a Global Strategist, and an Organizational Development Leader. He is a leading expert in the Corporate Governance and Leadership Advisory Industry.

George is a global member of the Institute of Directors (IoD), U.K. The IoD has also certified him as a Director. He holds an MBA and a Diploma in Marketing from Nottingham Trent University. George has attended and received specialized training in Executive Education for Leadership, Strategy, & Organization Development from Thunderbird University USA, the Creative Center of Leadership USA, and INSEAD Europe. He is a Strategic Business Partner of NASDAQ Governance Engagement Solutions, an Advisory Board Member of the NASDAQ Center for Board Excellence, and a Governance Advisory Council member of The Corporate Governance Institute UK & Ireland.

Click here to learn more about the author.

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About Stanton Chase

Stanton Chase ranks among the world's top 10 executive search firms. It has been a market leader for executive search and leadership consulting since 1990.

Stanton Chase operates through focused industry practice groups, each led by a global practice leader who is an industry expert. As an international firm with operations in over 45 countries, Stanton Chase provides both a global perspective and local insight.

Stanton Chase's experienced global consultants can help you every step of the way, whether you are looking for the best talent or making sure your leadership team is as effective as possible. Our core services include executive search, executive assessment, succession planning, and board services.

For more information, visit www.stantonchase.com or follow us on LinkedIn, Twitter, or Facebook.

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