CEO Succession: Increasing the Odds of Success in Any Scenario

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Q: What is the “Current State” of CEO Succession?

1. What is the average tenure for externally recruited CEOs?

- 40% last 2 years or less
- 64% last 4 years or less
- The failure rate is troublingly high
- The cost of failure is high
  - Median compensation for external CEOs is 65% higher than for those promoted from within. Added to this the opportunity cost and the impact on shareholder value.
- The succession event is fraught with shareholder risk
  - Investors are twice as likely to sell stock when a new CEO is named than to buy
Q: What is the “Current State” of CEO Succession?

2. How well do internal CEO appointments perform compared to external appointments?

- Internal promotions outperform external hires
  - Higher growth, earnings and stock appreciation
- External hires are riskier
  - They cost more, have shorter tenures and are twice as likely to fail than insiders (and the situation is even worse for superstar hires)
- External hires are nearly 7 times more likely to be dismissed after a short tenure than internally appointed CEOs.
- Yet, roughly 30% of successors are still hired from outside.
Q: What is the “Current State” of CEO Succession?

3. What percentage of Boards are prepared for CEO succession?

- 84% of directors surveyed believe the importance of having a CEO succession plan in place has increased.
- Yet only 16% of these directors feel their board is effective at succession planning.
- 42% of publicly traded companies do not have a formal succession plan.
- 62% do not have an emergency replacement plan.
- 50% have not documented the requirements for the next CEO.
- 50% have not engaged in discussions with the internal candidates.
- 61% have no internal candidate development planning process.
- 89% have no established benchmark against which to evaluate candidate skills and readiness.
Four Succession Scenarios

1. Emergency
2. Near-term (1-2 years) succession
3. Mid-term (3-5 years) succession
4. Long-term, 3rd generation succession
The Board’s Focus in Succession

Emergency Succession

- Develop an aligned view of the success profile for the job
- Identify at least one emergency candidate who is willing and would have the most essential experience and skills to handle the job in the near-term
The Board’s Focus in Succession

Near-term (1-2 years) Succession

• Develop an aligned view of the profile for the job
• Identify a pool of most likely candidates and confirm their interest
• Get a robust, objective view of their readiness for the job
• Develop readiness and track progress
• Benchmark external talent and, if needed, assess readiness of external candidates
• Review finalists and identify the successor
• Ensure a smooth transition
The Board’s Focus in Succession

Mid-term (3-5 years) Succession

- Develop an aligned view of the longer-term profile for the job
- Identify a pool of potential candidates
- Get a robust, objective view of their potential for the job
- Develop their potential
- Track progress annually
- When 1-2 years out, identify the most likely candidates
- Trigger the near-term succession process
The Board’s Focus in Succession

Long-term, 3rd Generation Succession

- Develop an aligned view of the longer-term profile for the job
- Identify a pool of potential LT candidates
- Get a robust, objective view of their potential for the job
- Develop potential
- Compare to external benchmark
- Track progress and pipeline annually
Sources

- National Association of Corporate Directors, 2009 Survey; Conference Board Director Notes 2010: BoardEx.
- Booz & Company 2011 study of 2500 largest public companies.
- Spencer-Stuart HBR study in 2010 on 300 CEO transitions at S&P 500 companies between 2004-2008.
- U of Indiana and AT Kearney 2011 study on S&P 500 companies.
- Stanford Graduate School of Business and Heidrick & Struggles 2010 study of 140 CEOs and boards of N. America public and private companies.
- Ang and Nagel, The Financial Outcome of Hiring a CEO from Outside the Firm (2011)