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# Best Practices For CEO Succession

*First-person stories on how boards make succession succeed.*

by Dennis Carey, Stephen P. Mader and Jane Stevenson

KORN/FERRY INTERNATIONAL

BOARD & CEO SERVICES

# Best Practices For CEO Succession

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**Passing the leadership torch from one chief executive to another is a fundamental moment for any corporation. Succession planning is a basic duty of the board, but also a potential crisis for the company's future if mishandled. Three leaders at Korn-Ferry have studied CEO succession in depth, and offer quantifiable rules on how boards can make a CEO change succeed.**

Two facts about CEO succession are unassailable. The first is that every chief executive now in office will, sooner or later, be replaced. The second is that preparation is key for a smooth transition.

Most companies are on the right path. They recognize that CEO succession carries risks even as it offers new opportunities. Reducing those risks, by using best practices, is among a board's most important tasks.

To identify best practices, three vice chairmen at Korn/Ferry International with expertise in CEO succession—Dennis Carey, Stephen Mader, and Jane Stevenson—interviewed current and former top executives and directors at four companies that had changed chief executives in recent years: AmerisourceBergen, Marriott International, MasterCard Worldwide, and Newell Rubbermaid.

**Depending on the board's composition, transition situation, and dynamics, some benefit from the involvement of all directors and others from an effort primarily led by a committee.**

Ten guiding principles for boards emerged from the interviews:

☐ *Discuss and plan* for CEO succession on an ongoing basis so that the board is prepared not only for orderly transitions but also for the unexpected.

☐ *Decide how involved* the full board should be in the succession process and how the process should be led. Depending on the board's composition, transition situation, and dynamics, some benefit from the involvement of all of the members and others from an effort primarily led by a committee.

☐ *Be clear about the sitting CEO's role* in CEO succession. If a transition is underway, should the CEO lead a specific segment of the process, be cast as a key advisor, or have no part?

☐ *Commit to continual, open communication.* Keep the entire board in the loop on problems and progress at all critical points.

☐ *Look for certain qualities* in those directors leading the succession work. Are they strategically minded and highly disciplined? Do they possess a balance of judgment and intuition? Do they have CEO experience themselves?

☐ *Make sure that corporate strategy is the ultimate driver.* Agreement is needed on where the company is going before someone can take it there.

☐ *Recognize that internal candidates* typically need three or more years of targeted development to step into the CEO role.

☐ *When the situation permits, lower the risks* of choosing an outside candidate by bringing that person in early enough to be integrated into the company before being appointed as CEO. Both the candidate and the board should become comfortable with the fit.

☐ *Do not rule out sitting directors* as CEO candidates, but do tread carefully concerning the process and consequences of engagement. Make sure that a director is not an active candidate and a director with accountability for the CEO decision process at the same time.

☐ *Use a mix of incentives* to robustly fill the succession pipeline. In addition to making talent development a factor in annual bonuses for a sitting

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CEO, consider providing future financial upside through equity or incentive payments, based on the successful transition of the new CEO.

Ultimately, each of the four companies wound up with a CEO transition that was tailored to its own needs and realitites. Companies that understand the right process, and apply it effectively, generally come out with a good choice.

**"When you have [succession responsibility] only in the governance committee or the compensation committee, you run the risk of having too limited a focus."**

☐ *AmerisourceBergen.* It was CEO R. David Yost who set the timetable for the search that replaced him at AmerisourceBergen. "I was sixty-two when I stepped forward and said to the board, 'Hey, guys, I just want you to know that I don't see myself doing this for the rest of my life. I mean, sixty-four or sixty-five is probably going to be it for me.' "

It was 2009 and Yost had been chief executive for a dozen years, first at AmeriSource Health Corporation and then, after its merger with Bergen Brunswig Corporation in 2001, at AmerisourceBergen. As a result, he had been the new company's only CEO—making the choice of a successor that much more significant.

In Yost's view, the key to being ready for a CEO succession is for the whole board to see the process as a continual effort. His board spent time on succession planning at every meeting.

"When you have [succession responsibility] only in the governance committee or the compensation committee, you run the risk of having too limited a focus," Yost said. "You also want to be careful not to alienate the board—the succession process is best served by having the full board involved."

The leader of the succession effort, Yost said, must be able to keep everyone focused on answering one central question: What do we need the next CEO to do? That task involves looking at strategic plans and asking where the company is going to be three to five years down the road and beyond. What are the skills that are needed to take the company there—skills that may be substantially different from those of the incumbent?

At the same time, the board should be considering internal candidates who might be ready in two or three years. What is required to develop their skills to meet those anticipated needs? It is also prudent to bring in independent consultants, Yost said, both to keep the board focused and to offer objective insights.

At AmerisourceBergen, any abstract thinking became very concrete once Yost announced his retirement plans in 2009. As for the division of labor, the board worked primarily on defining the strategic needs. "I probably had the most influence in assessing the leadership skills," Yost said, "because as CEO I was working with the internal candidates on a day-to-day basis."

He and the board decided not to look at external candidates until the pool of internal ones could be thoroughly assessed. With the help of their outside consultant, they identified three or four areas for development in the leading contenders. Some board members participated directly in that effort, meeting with the candidates to offer their views on how each was doing.

At the same time, Yost kept an eye on external talent. AmerisourceBergen had made a number of key hires from the outside over the years, including its head of human resources and chief information officer. "I kept very wired to who was out there and who was looking around," Yost said.

After about a year, Yost said it became apparent who the successor was going to be—Steven H. Collis, who was then executive vice president and also president of AmerisourceBergen Drug Corporation, the company's largest subsidiary. That halted any external search before it really started. "Now that's a little bit of a risky run by not testing the marketplace, because you don't know who is going to stand up," Yost confided. "But we decided that it was not too big of a risk—it was highly remote that we would find someone better."

When Collis first emerged as a CEO candidate, he was moved to the drug subsidiary to gain operational experience. The move was controversial, Yost

## Who Steers The Succession Process?

### Oversight In The Korn/Ferry Market Cap 100

*CEO succession planning responsibilities are often divided among individuals, committees, and the full board. Nearly half of the companies on this year's Korn/Ferry Market Cap 100 list indicated in their proxy statements and principles of governance that the full board was involved with succession planning.*

**Charged with oversight of succession:**


recalled, because Collis had been doing such a great job at their specialty unit. He was then promoted to chief operating officer in November 2010 to run all of the company's businesses. This shift was understood by the board, but not outsiders, as a sign that he had been tapped as the heir apparent.

**The CEO is just one in a never-ending line of company stewards, each responsible for putting the firm's interests ahead of his or her own.**

The grooming process touched other areas as well. Collis gained more exposure to Wall Street, for instance, by attending investor conferences with the chief financial officer. He got some mentoring from experienced CEOs about the complex relationship that he would have to forge with the board.

Yost felt confident about passing the baton to Collis on July 1, 2011, his sixty-fourth birthday just days away. Yost had thought the succession might not come until he turned sixty-five, but he could see that Collis was ready and should step in at that point, fully engaged and fresh for the task. Delay could well be counterproductive.

Problems arise when the CEO "wants to be remembered as the greatest deal that ever was," Yost said. "That's not the proper role, which is to make sure that your company goes on in perpetuity without you."

To that end, Yost suggested that part of a CEO's bonus (and that of other senior managers) should be tied to executive development. To further incentivize the CEO, a post-succession bonus, say two years down the road, would also be a good idea, he added. "The CEO needs to be ready to go, and to understand that he will be judged by how well his successor does," Yost said.

In other words, the CEO is just one in a never-ending line of company stewards, each responsible for putting the firm's interests ahead of his or her own. That includes not only identifying the best successor, but also recognizing the time is right for the company.

At AmerisourceBergen, the stars aligned perfectly. "My successor was ready," Yost said, "the board was ready, I was ready."

**Sometimes, the CEO must be told it is "the board that makes the decision and you're just one member. It's the board that must live with the decision, not you."**

☐ *MasterCard.* Many times, there is no "right" internal candidate, and the search for a new CEO leads to someone from outside. In theory, this is a riskier proposition if only because of the unknowns: What is this candidate really like? How well does he or she understand our needs? Can the new person mesh well with our culture?

One way to reduce those risks is to recruit a prospective successor before the baton is expected to pass. That way the candidate can become a known quantity.

In late summer of 2009, MasterCard brought in Ajay Banga, a senior executive at Citigroup, to be its president and chief operating officer. Less than a year later, he was named to succeed Robert W. Selander, MasterCard's CEO since 1997.

"This was a succession that could be planned a long way in advance because we knew Bob's retirement date," recalled Richard Haythornthwaite, MasterCard's non-executive chairman, who led the search. That retirement date was the end of 2010. The succession process started in mid-2008.

There were three problems, though. First, MasterCard had become a public company through a stock offering in 2006, and the full board had been in place for only a couple of years; the directors felt as if they were parachuting into the succession situation. Second, the board was uncertain about the prospects for an internal finalist. Finally, the financial crisis that was roaring in full force in 2008 put a cloud over the field of outside possibilities.

Also, the succession effort needed clear leadership because of the highly diverse nature of MasterCard's board. Its directors had richly varied governance experiences and, although very aligned on the long-term objectives of the company, they held a robust range of views on shorter-term priorities.

### The leader of a CEO succession needs to be strategically minded and disciplined to run the process tightly.

Logically, the person at the helm of a CEO succession would be the nonexecutive chair/lead director or the chairman of the nominations committee, said Haythornthwaite. This leader needs to be strategically minded and disciplined to run the process tightly. A good balance of judgment and intuition is also necessary, and CEO experience helps. The chief executive's role is "enormous in terms of accountability, and people who have not been in that position can never quite understand that," he said.

A close relationship with the incumbent CEO is also essential. "Things come out of the woodwork, for example, the CEO's view of the role that he or she should be playing in the succession process," Haythornthwaite said.

Some CEOs, for instance, subconsciously enter the process thinking it's their job to find the successor. "That's quite difficult. Sometimes, some pretty tough conversations have to be held saying, 'No, that's not the way it is. It's actually the board that makes the decision, and you're just one member. And it's the board that must live with the decision, not you.' "

In MasterCard's board structure, a human resources/compensation committee had been working on a continuing basis with Selander on leadership development and succession planning. In theory, it was the nominating and corporate governance committee (which Haythornthwaite headed) that was responsible for the actual selection of the next CEO. In practice, the chairman of the HR/compensation committee, David Carlucci, was co-opted in and a de facto search committee formed.

When the search committee members reviewed Selander's list of top internal candidates, Haythornthwaite recalls "we came at it with an open mind" but recommended to the full board that it pursue an external search. That recommendation was accepted. Then the task became one of getting Selander to agree that the next CEO would come from outside the company. "That's why it is important to have a good working relationship with the outgoing CEO," the chairman said. "That's not an easy conversation to have."

Not only was Selander gracious and understanding of the board's view, he remained fully involved in the process of finding that outsider. "We cannot imagine a world where we would move forward with someone that you didn't think was an appropriate candidate," Haythornthwaite recalled telling Selander, "not least because there is going to be a transition here." Although the final recommendation would come from the search committee, he added, "it had to be a consensual decision."

So, even though Selander was not an official member of the board's search committee, Haythornthwaite made sure that he was invited to every key discussion and spent time with short-listed candidates before they completed the interview process.

When the search got underway (with the support of an external consultant), the search committee found that candidates fell into two categories. One group had the strategic vision, ideas, and wherewithal to make big changes. They would ensure that the company could respond to the significant systemic challenges that it faced.

The other group, the chairman said, was less creative and more buttoned-down, but would be better suited to lead the company through a short-term period of market weakness. Different directors favored different candidates depending on their expectations of the external world.

A number of candidates were considered, some seriously. Still, no one completely clicked—until a director suggested Banga, then chairman and CEO of Citibank's international global consumer group.

"I looked into Ajay and met him at my home," the chairman said. "And he was the first person who really straddled the two groups. From the moment I met him, I just felt this is the individual we'd been looking for. You have to come in with a strategy before you come in with people. The people need to be a fit to the strategy."

Banga was Indian-born and educated, had worked at Nestlé and Pepsi before joining Citi, and put in tours of duty in the United States, Europe, the Middle East, Africa, and, of course, India. He was almost as international as MasterCard itself. (Based in Purchase, New York, MasterCard operates in more than 210 countries and territories and has annual revenues of $6.7 billion.)

Meetings with the search committee were hastily arranged and all came to the same conclusion. As did the board. "It was unanimous," the chairman said. "We closed the deal pretty rapidly."

Banga joined MasterCard on August 31, 2009, as president and COO. The following April he was named CEO, formally replacing Selander on July 1, 2010. Selander, who had been CEO for thirteen years, stayed on as executive vice chairman and a director until he retired at the end of 2010.

**For a CEO transition, "It's always better to make it quite short, with the option to lengthen it. It's a lot tougher to have it long and try to shorten it."**

"Coming from the outside to become the CEO is not an easy thing to do," Banga said. "Having this little transition period gave me a chance to learn the company, get to know the people, and have someone to sound out ideas with. It was very helpful." It also gave him time to get to know the analyst community, the media, regulators, and, clients—before facing the daily pressure of producing results as the CEO.

When determining the length of this sort of transition, the board has to be extremely careful, Haythornthwaite added. "It's always better to make it quite short, with the option to lengthen it. It's a lot tougher to have it long and try to shorten it."

When it comes to succession, Banga and others we interviewed made an important distinction between the development of a talent pipeline of future leaders and the actual search for and selection of a new CEO. The nonexecutive chairman or independent lead director should head the latter effort, including any external search. However, the identification and development of future leaders should be driven by the chief executive and overseen by a board committee.

Likewise, Banga sees different skills at work. The CEO change manager needs to be inclusive and draw in a wide group of board members. That leader needs some longevity to understand the company. This leader should also have a grasp of challenges facing the company, and appreciate the capabilities that the new CEO must possess to meet them. The leader also needs experience in managing an organization to understand the politics and logistics of settling into a new company.

By contrast, those committee members with ongoing oversight of the talent pipeline are in it for the long haul. Though they need not have CEO experience themselves, they do need senior management experience and longevity, and they must be very process-driven.

How do you build a pipeline two or three levels down from the CEO? How do you identify and develop missing skills in those people? How do you pick jobs that they should move into? "The results may take years to play out and there is a lot of ambiguity involved," Banga said. "But some people are only interested in the end conclusion—they want to see the last page first—and they shouldn't be involved."

Banga takes a hands-on approach to developing his executive team. He uses each board meeting to introduce some of the 80 or so rising talents in the company. Each year he leads a "people conversation" with the board, discussing the layers of leaders. In future years, these will move up to the thirty-five-person operating committee, and later the eight-person executive committee. When Banga saw gaps in key skill areas for example, he took action. The solution: "Let's go hire four or five people, some relatively senior. We briefed a search company and by May 1 had them all in."

Ideally, someone should be ready to take over tomorrow morning, at least on an interim basis, with a permanent replacement ready in a year or two and other internal candidates being groomed for the five-year horizon. "You just hope that by the time we get to the point of succession, we've got three or four good internal candidates," Haythornthwaite said. "It's always a challenging process because the end time is generally not as precise as it was with Bob. And so there's a hedging process that goes on with the development."

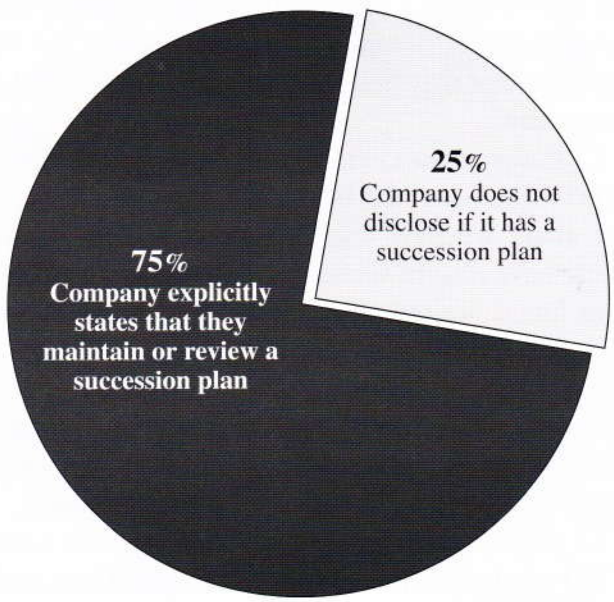
When it comes time to make a change at the top of MasterCard, Banga said he will be ready to hand the final decision over to the board.

A sitting CEO "should not have an equal say in succession decisions," Banga added. "Once the board and its committee are comfortable and they've got it down to the one or two people they really like, they can ask me for my opinion, but finally they should be making every call. My opinion as CEO should, at best, just be interesting to have."

**CEO succession is an ongoing process that begins anew the day after a CEO is chosen. Yet most companies are not prepared to name a new CEO should the need arise.**

## Talking About Succession

**Most Companies Disclose A Succession Plan**




☐ *Conclusion: Winning a race with no finish line.* CEO succession may not be rocket science, but it is not a cookie-cutter process, either. The guiding principles for getting it right not only have to be understood, but also adapted to a company's particular situation.

The common denominator, though, is a commitment to continuing the succession process until the company hits pay dirt.

"In the end, you've got to wait for the right candidate to come along," MasterCard's Haythornthwaite said. "You have to make expedient decisions as you go—and you have to have a bit of luck thrown in."

Details always vary, however ten guiding principles stand out as a bold outline of an effective succession.

☐ *Never stop planning.* CEO succession is an ongoing process that begins anew the day after a CEO is chosen. "It is important that you not only have a long-term plan in place but also a 'train wreck' scenario, should the CEO become incapacitated," said Yost. Yet the majority of companies may not be prepared to name a new CEO should the need suddenly arise, according to proxy and governance statements filed by firms that are on the 2012 Korn/Ferry Market Cap 100. Only 17 percent indicated that they had identified an interim replacement, annually reviewed a list of candidates, or had written procedures in place. Further, 25 percent did not indicate that they had any succession plan, short or long term.

☐ *Pick your succession leader with care.* Whether it is the lead director, board chairman, or a committee chair, whoever leads a CEO selection process must have a solid sense of the company's strategy and future outlook. He or she needs to be: highly disciplined, able to devote significant extra time to the task, intuitive about people, and trustworthy in the eyes of the board. CEO experience is also highly recommended so that the search leader knows firsthand what the role will demand of a candidate.

☐ *Define the board's role.* The search for a new CEO can be run boardwide or delegated to a committee. Pick the structure that plays to your board's strengths and dynamics, recognizing that there are tradeoffs in each approach. Involving every director may require more time to make decisions and pose confidentiality issues. A narrow approach may limit the process' focus and make final consensus harder.

☐ *Define the current CEO's role.* The CEOs in some circumstances lead and manage the succession process. In others, the CEO is cast as an important advisor. The key is to make a conscious decision and reach a clear agreement with the CEO on his or her participation.

☐ *Keep talking.* Recognize the central importance of communication to the full board, particularly if the search process has been delegated to a committee. This is essential both to keep the directors informed and to detect and address issues as they surface. Also, directors often give access to useful information out in the market.

☐ *Agree on the strategy first.* The board must reach consensus on the future business environment and the strategy to address it. Then, and only then, is it ready to define the attributes that the new CEO must have to pursue that strategy. Remember, though, the process used to win alignment on strategy can vary.

☐ *Develop and test internal candidates.* Preparing viable internal candidates for future succession is a long-term process that typically requires at least three years of focused effort with high board participation. The identification and development of future leaders requires filling seats in the second and third tiers of management as well as at the top of the house. Banga, MasterCard's CEO, is a great example. He showcases 75 to 80 rising stars to his board on an ongoing basis.

☐ *Give a prospective CEO a head start.* When possible, lower the risks of choosing an outsider by strategically bringing the person into the company with enough time to learn its culture and how its current leadership operates. This way, by the time the succession is finalized, the new CEO and the board should be deeply familiar with each other and comfortable with the fit. "The idea is to go outside in advance with a runway to make sure that the flight path to the CEO's office is going to work," says Steve Mader, one of this report's authors.

☐ *Do not rule out directors.* On the other hand, never appoint one with the anticipation of CEO succession. If a strong candidate happens to be on the board when a successor is needed, the director's title need not be an insurmountable barrier. There are two choices when considering a sitting director: bring the candidate into the process with the understanding his or her director status will terminate regardless of the outcome, or keep the candidate out of the main search process and proceed along a separate discreet path. The candidacy is then "reversible," and the directorship remains viable should either party not want to go further.

☐ *Use a mix of incentives to prime the pipeline.* Part of a CEO's annual bonus should be tied to executive development. Some companies go one step further: providing for a bonus after the CEO has left if the successor he or she helped to select was, in fact, a winner. ■



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