

## FROM CHECKERS TO 3-D CHESS

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*“Business is a highly-charged and ever-changing environment. Businesses strive to evolve so they can maintain their fitness to compete. CEO succession has to start with, and run in parallel to, the incumbent’s role if a business is to have any hope of keeping up momentum. Missing this nuance means it is doomed to making transitional decisions that could have a negative impact on the future.”*

—James P. Hackett, CEO and  
president of Steelcase, Inc.

It is very difficult for a leader—any leader—to step down and hand over the reins of their company to someone else. Human nature being what it is, power is a most difficult force to surrender to another. Those who aspire to positions of leadership are ambitious, highly motivated, and exceedingly driven individuals, so any activity involving the interplay of personalities, emotions, ego, and legacy is going to present relational obstacles when planning and executing the transition from one chief executive to another. Given the ever-present undercurrent of these powerful social and psychological forces, CEO succession will always prove a most difficult reality for many CEOs to gracefully accept, and is one of the most challenging activities for a board of directors to oversee.

What has added to the complexity of CEO succession planning over the years are the demands of a rapidly changing and highly competitive business environment. The succession process itself, and the ramifications of transitional decisions, were far less complicated and consequential sixty-seven years ago when RHR International began advising and guiding companies in their CEO succession planning. The business environment then was far simpler when compared to the speed, complexity and uncertainty of the business world we live and work in today.

Yet with all that has changed over the years in the conduct of business, the discipline of succession planning has not kept pace and advanced accordingly. The hesitant mindset of CEOs and boards—combined with the displacement of the critical tasks related to succession planning by the urgent matters of the day—have repeatedly proven detrimental to continuity of leadership and growth of many companies.

## A SIMPLE, MORE PREDICTABLE WORLD

The years following World War II ushered in an economic boom and an end to the Great Depression. The post-war period also set in motion an explosion in consumer purchasing power, fueled by credit cards, shopping centers, the “golden age” of television, and the interstate highway system. AT&T was everyone’s phone company, and the Big Three were the only three in North America.

Conducting business in the 1950s, 60s, and 70s was analogous to a game of checkers. Winning was simply a matter of staying one or two steps ahead of competition. Though every move had the potential to bring about a variety of counter-moves, the CEOs of many of the *Fortune* 500 companies at the time could comprehend the entire playing board at once and make short- and long-term decisions with a high degree of confidence.

The business environment was straightforward and, to a certain degree, predictable. Companies engaged in commerce primarily in their own country, encountered known competitors, served traditional market segments, and offered limited product choices.

Not that it was idyllic, but in that era, a company’s stakeholders consisted of devoted, lifetime employees, loyal customers, dependable suppliers, responsive distributors, and moderately involved boards of directors. That period of economic growth was also accompanied

by a relatively favorable media, limited government regulation, less litigation, and few, if any, activist consumer groups. Of course there were labor and management concerns, as we have today, but the point is, the times were simpler and any surfacing issues could be isolated and quickly rectified.

From the 1950s through the early 1970s, long tenures for chief executives were common and dismissals were rare events. Many CEOs ran their businesses for ten to twenty years and their personas were inseparable from that of their company's identity. During those formative decades of modern commerce, retirement was usually the only way long-serving chief executives parted with their companies. And when CEOs were ready to retire—often at a time of their own choosing—they had a good idea as to whom their successor would be, as did most others in the organization, including the board.

The role of the incoming CEO was to maintain the business. The belief was that if the incoming CEO could stay the course, steadily gain market share, and control spending, the company would thrive for decades to come.

For most companies at the time, the requisite skill set of a succeeding CEO centered on understanding the company's products, markets, distribution channels, and competition. That candidate was most likely already on the executive team and in consideration for the top spot. In the 1950s, only one out of ten successors was hired from outside the company, and by the 1970s, only one out of seven.<sup>1</sup>

Boards of directors, at the time, were involved in overseeing major corporations, though their role in the CEO succession process was usually limited to being made aware of and approving the CEO's handpicked successor. If the CEO felt comfortable with the candidate, the board would take the CEO's lead. Board members would endorse the CEO's choice, but otherwise stayed on the sidelines and out of the process. They became involved only if a crisis—such as in the CEO's death—forced them to step in and name a successor.

Craig Sturken, chairman of the board of directors for Spartan Foods, Inc., remembers that business period as one of far less board involvement in CEO succession planning:

It was easy to be aligned with the CEO and the company's business strategy. There were no external constituencies as we have today, tracking and blogging our every move. The trajectory of

the company was known to everyone in the organization and all of us on the board. We could see five to ten years out with a high degree of certainty and we easily approved the person the CEO recommended as his successor.

In those early years, there was little movement of employees from one company to another. As a result, employers knew a great deal about the personalities, talents, and skills of each executive. In the 1950s and 60s, *Fortune* 500 executives remained with their companies for an average of 24 years.<sup>2</sup> This stability epitomized the generational attitude at the time. The Silent Generation (1925–1942), born during the Great Depression and World War II made up over 90 percent of the workforce—vastly different when compared to the four generations at work today. They were labeled “silent” because of their withdrawn, cautious, and unadventurous orientation—understandable, given the hardships they encountered during their childhood years. They viewed work as an obligation and their sense of loyalty to their employer precluded them from leaving their companies for a better paying position elsewhere.<sup>3</sup>

Companies back then were not as interested in a potential successor’s performance as they were in that person’s character. Given the direct, linear path of business at the time, companies were content with sustaining success and advancing through incremental gains in the marketplace. As a result, employers spent more time shaping select executives to be market planners rather than market insurgents.

Dr. Alice Tybout, Harold T. Martin Professor of Marketing at the Kellogg School of Management at Northwestern University, notes:

‘Checkers’ is the perfect analogy for the way business was conducted in the United States and quite possibly was the mind frame of senior executives at most companies in developed and developing nations. Strategy involved linear moves that required a steady, trusted leader who knew the organization and its capabilities well. CEO succession planning was limited and boards accepted whomever the CEO chose as his successor. This approach worked reasonably well when the business climate was fairly predictable, as was the case through the 1970s. What many companies didn’t realize, or prepare for, was just how much things could change in a few short years.

In the 1950s and 60s, there was a sense of confidence within the business community that almost any market problem could be solved and any challenge overcome. Companies such as GE, AT&T, Procter & Gamble, HP, and IBM became known as “academy” companies, patterning their development of leaders after the military model of bringing in new recruits, moving them through a series of jobs and training exercises, then advancing those who continue to perform well.

However, by the middle of the 1970s, CEOs and their boards began to realize that conducting business was becoming more difficult and less predictable. The economic upheavals of the 1970s—energy shortages, inflation, and the beginnings of international competition with companies such as Toyota, Nippon Steel, and Sony—revealed that corporate leadership had become somewhat inbred, habitual, and lethargic. Whether the result of being stuck in outdated traditions, fearful of risk and failure, or merely absorbed in denial, CEOs and their boards—across a number of industries—were slow to respond to the challenges they faced, and their companies’ profits and share prices began to decline.

## CAPTURE THE KING

By the 1980s and 90s, business had become more like a game of chess. Lateral moves were no longer enough to sustain a company’s success. The game of simple battles had morphed into a game of campaigns with marketplace skirmishes occurring simultaneously and on different fronts.

Many companies were, for the first time, playing on a global stage, entering new markets, appealing to unfamiliar cultures, and contending with deep-rooted, in-country competitors. CEOs and their executive teams required newer skills including broader vision, cultural awareness, strategic alignment of resources, and thinking three or more moves in advance—a more challenging game, but still comprehensible.

Against this backdrop of dramatically changing market dynamics, compounded by more companies engaging in mergers and acquisitions as part of the business strategy du jour, the task of CEO succession became increasingly challenging, requiring greater deliberation, more attention to diverse talent retention and development,

shorter tenures, and greater collaboration between the board and the CEO.

Proper CEO succession now necessitated an ongoing, well-administered process, a discipline few companies had to contend with prior to the 1980s. That requisite level of process and planning pushed against the demands of time and resources for many organizations. That reality, coupled with the need for growth in foreign markets, forced many CEOs, more than ever before—and in many instances for the first time in their company’s history—to search outside the organization for their successor.

By searching externally for candidates, CEOs were conceding that their companies had a failed internal succession planning process and had not devoted enough time to talent development.

According to Michael Useem, director of Wharton’s Center for Leadership and Change Management, “The trend line from 1970 to 2000 shows a slow but steady increase in the number of companies that look to the outside in the case of a departing CEO. At the start of that period, one in seven new CEOs at major companies came from outside the firm; by the end, one in four.”<sup>4</sup>

As Tim O’Donovan, retired chair and CEO of Wolverine Worldwide Inc., sees it,

From time to time, a company may face performance issues or the need for a significant shift in strategy. In those circumstances, it may be preferable and even necessary to look to an outside leader to be the catalyst for change and reinvigoration of the company.

The fast-changing business landscape of the 1980s and 90s forced many CEOs and their companies to shake off their denial and complacency in the face of change, attitudes that disabled American Express, Citibank, Digital, General Motors, IBM, Kodak, Tandy, Xerox, and so many others.

How quickly things changed. In 1980, Sears’ marketing plans did not even mention Wal-Mart as a competitor, yet by the end of that decade, Wal-Mart had passed both Sears and Kmart to become America’s largest retailer, and by 1992, employed more people than GM, Ford, and Chrysler combined. After Mercedes’ sales in

the United States dropped 24 percent in 1991, its top management finally conceded that it had to change its strategy because of Japanese competition. Until then, Mercedes' management refused even to acknowledge the existence of competition in its high-end market sector.<sup>5</sup>

Prior to the late 1970s, boards relied on the CEO to define and set the strategic direction of the company. Directors had little insight into the company's business and even less knowledge of the bench strength of the company's executive team. But in the 1980s and 90s, loss of market share and product failures caused such attitudes to change. Shareholders' increasing expectations for performance had a dramatic effect on the relationship between the board and the CEO, further deepening the involvement of the board in the strategic direction of the company.

A climate developed in which individual directors began to raise questions and debate the issues introduced by the CEO rather than merely approving their formal presentations. Boards began to take a more active role in understanding and responding to the CEO's strategic decisions, and took it upon themselves to become more fully informed in their company's businesses.

James P. Hackett, CEO and president of Steelcase, Inc. recalls it:

Our more active participation in providing strategic oversight helped generate a better understanding of the strategic direction of the company as we approached the new millennium. It gave us a better understanding of the capabilities required of the company's leadership and the mindset and skills required of the CEO. We began to realize, I think for the first time, whether the CEO had the required talents needed to sustain the success of the organization.

## DECLINE IN CONFIDENCE AT THE TOP

At this time, and for the first time in any significant numbers, more and more chief executives began leaving their companies for a number of reasons other than retirement. Some CEOs were drawn away by competing firms offering more attractive opportunities. Many were taking their stock options and cashing out. Others were

pushed out, well before retirement age, due to active takeovers or dismissals by their boards for poor company performance.

In addition to capturing the attention of boards, lackluster sales and profits also attracted the attention of Wall Street analysts to the issue of CEO selection. This magnified in the early 1990s when the boards of American Express, GM, IBM, Kodak, and Westinghouse fired their CEOs following prolonged periods of poor performance in the face of a rapidly changing business environment.<sup>6</sup>

The relatively sudden replacement of the CEOs with outsiders in these high-visibility companies—for the first time in their corporate histories—signified that qualified, internal successors were not being developed to assume the reins of responsibility.

In addition to losing their CEOs and any semblance of continuity in leadership, these multi-billion dollar international companies immediately lost investor confidence and stock price value. Statistics have shown that in planned CEO turnovers, a company's stock price will historically lose an average 0.8 percent value—a relatively stable retaining of market value. But in unplanned CEO turnovers, stock prices will lose an average 12.6 percent in value.<sup>7</sup>

While Wall Street may have commended the boards of these companies for taking the necessary step of replacing their CEOs, the reality was that these boards did not intervene until these huge companies reached a critical stage of failure, suggesting that the boards of each of these companies were not proactively engaged in leadership continuity planning. And, if board involvement in CEO succession planning was low or nonexistent at these *Fortune* 100 companies, what was not being practiced in the *Fortune* 1000?

At the close of the twentieth century, the sudden loss of confidence in these pillars of commerce increased the scrutiny of Wall Street analysts and heightened the expectations of shareholders—both seeking better corporate governance and improved stock performance. It also provoked government and consumer groups to take a closer look at and more active stance in regulating and influencing management activities in corporations.

In the decades of checkers and chess, the CEO led the succession process, making all major decisions regarding their successor and the timing of their transition. The board rarely acted to override the CEO's decisions or step into what was perceived as the CEO's turf.

However, by the end of the 1990s, the increasing complexity of business and high-profile failures in leadership continuity in a number of major corporations indicated that it was no longer wise to leave succession planning solely in the hands of the CEO. The growing expectation on the part of stakeholders was that CEO succession planning needed to be a continuous process and a shared responsibility between the CEO and the board—with the board having ultimate accountability for its thorough implementation and successful outcome.

### **3-D CHESS: MORE LEVELS OF PLAY—LESS CERTAINTY OF OUTCOME**

Today, the world of business is moving at a much greater pace than at any other time in history. In this constantly changing business climate, CEOs and their leadership teams make few decisions and take few actions with any degree of confidence or assurance of a successful outcome.

There is no longer a definitive endgame in sight for a CEO's actions in the marketplace—at least not within the time frame of the top leader's shortening tenure. The outcome of decisions made may not be known until several years later and most likely during the next CEO's administration. The game has morphed into one of three-dimensional chess where one move on one level can affect strategies and outcomes on a number of other fronts. Given this increased level of complexity, the reality of business in the twenty-first century is one of constant competitive uncertainty and unforeseen consequences—further complicated by more stakeholders demanding greater transparency and increased regulation.

Since 2000, the globalization of business and the interdependence of global economies have accelerated at an unprecedented rate. The speed of technological change, the internationalization of capital markets, the acceleration of regulatory requirements, and the diversity of the workforce and its changing generational attitudes have each impacted companies and their leaders. And to ratchet up an already frenetic condition, the severe global economic downturn in these most recent years has aggravated matters even more.

The business practices and market decisions of corporations and even the personal lives of their CEOs have become far more transparent than ever before. Executives operate under the constant surveillance of 24-hour news cycles. And just as the Internet has enabled even the smallest business to appear as large as a multinational corporation, an individual with a blog and a personal agenda against a company or CEO has the equivalence in reach and credibility as any international news outlet.

Internal stakeholders including employees, boards of directors, customers, suppliers, and increasingly more external constituents including government agencies, environmentalists, consumer groups, and other organizations have escalated their expectations for personal involvement. These stakeholders have moved from merely wanting to be informed to expecting to participate in and affect the decisions of the company.

CEO Doyle Beneby of CPS Energy describes the business climate today as one of increasing uncertainty:

Throughout my career, I always felt I could solve problems with a reasonable chance of success. Yet, in today's business environment, I sense that events impinging on my company could really be—for the first time—out of my control. Moreover, I have to be very careful about statements made to the media for fear of being misconstrued. Every decision is scrutinized and can have an immediate effect on my company's stock price.

The recession that began in 2008 resulted in a number of unplanned CEO departures and outright dismissals, made very public by the media due to the severity of the current cycle of economic decline. Some companies were prepared to manage the sudden transitioning of their leadership, but as was discovered in the high-profile failures in the 1990s, many had no leadership continuity planning process in place. It seems not much has changed.

In 2008, eighty of the *Fortune* 100 appointed a new CEO with 45 percent of those companies going outside to find their successor.<sup>8</sup> While each of these companies had a CEO succession planning process in place, the fact that almost half of them had no internal successor ready to assume the top leadership position suggests that some

of these companies may not be adequately preparing their internal candidates. Given that these are of the largest companies in the world with the depth of resources and drawing power for talent at all levels, something seems amiss.

Shareholders have become acutely aware of the need for CEO succession planning and change in a company's management is now one of the most important areas for investors to follow. Shareholders are also beginning to realize—especially given the high-profile departures and dismissals of CEOs—a greater need for corporate governance and that CEO succession planning depends, in large part, on a sound process originating at the board level.

In October 2009, the Securities and Exchange Commission issued guidance stating that “Companies should no longer expect to be allowed to evade shareholder proposals regarding CEO succession planning.”<sup>9</sup> Reversing a long-held earlier position, the SEC now regards CEO succession planning as a “significant issue involving the governance of the corporation, that poor CEO succession planning poses too great a business risk, and that there should be greater transparency and shareholder disclosure about the management of succession.” This change indicates that the SEC regulators have repositioned CEO succession as a “risk management issue” and places its responsibility in the boardroom and not in the office of the CEO.<sup>10</sup>

The tipping point for the SEC reversal may well have been the announcement by Ken Lewis, CEO of Bank of America Corporation, on September 30, 2009, that he would retire at the end of the year. It soon became apparent that Bank of America's board had no successor in place and would most likely have to bring someone in from the outside. The timing could not have been worse as this announcement came in the middle of the deepest recession in decades. Not only shareholders, but also the media and the public-at-large became keenly aware that the biggest bank holding company in the United States and one of the world's largest financial institutions had no successor to replace its departing CEO.

One of the earliest and most visible tests of the new SEC guidance came in February, 2011, on the heels of Apple CEO Steve Jobs' January announcement of an indefinite medical leave from the company. Central Laborers Pension Fund, a union in Jacksonville, Illinois introduced a proposal that called for Apple's board to spell out its

criteria for choosing the next CEO. The union demanded that Apple name internal candidates for the job and that Apple begin a “non-emergency CEO succession planning” process and report on it to shareholders each year.

That same February, at Apple’s annual shareholders’ meeting, Apple’s board urged its shareholders to vote against the union’s proposal on the grounds that disclosing Apple’s succession plans would give the company’s competitors an unfair advantage. The board felt that such disclosure would encourage rivals to undermine Apple by luring away the company’s high-value executives who were not in the running for the CEO position. The board also argued that revealing the company’s succession plans could even affect Apple’s ability to recruit new talent, whether they were executives or even engineers. The proposal was soundly rejected by shareholders and did not even pass the preliminary tally.

While it remains to be seen if any similar proposals by shareholder groups will succeed, it seems inevitable that boards will need to be more deeply involved in the way CEO succession planning is managed, and that from a selection of well-qualified candidates, a successor is ready to assume the top job.

Though we clearly agree with the SEC that CEO succession planning is a significant issue involving the governance of the corporation and that its absence poses too great a business risk, we consider it somewhat naïve to suggest that there be greater transparency about whom the candidates are and precisely how the process is being managed. Such guidance defies an understanding of business and any comprehension of the negative impact of such disclosures on a company—from the loss of talent internally to the competitive pressures externally.

Shareholders are right to expect that companies have a CEO succession process in place. There are far too many instances over the past 20 years of poor board governance and high-profile companies failing at leadership continuity. Because of highly visible failures in succession, demands for transparency from regulatory and activist groups have swung like a pendulum, overcompensating to an extreme. The only way to forestall such extreme demands is by boards being more proactively engaged, having a best-in-class CEO succession process in place, and persuasively communicating to their constituents their confidence in and accountability for that process.

## FAR MORE THAN THE TRANSITIONING OF THE TOP LEADER

It seems that the importance of the issue of CEO succession in this rapidly evolving business environment and the orientation and preparedness of board members are certainly at odds. This disconnect can be attributed to several factors: it is a challenging process, it takes time, and it may not be perceived as an urgent matter when compared to more immediate business issues. Moreover, the mere mention of succession planning conjures up a host of organizational dynamics and powerful psychological stress points, for issues of power, ego, legacy, and personal agendas have as much if not more influence on the process as objective data, procedures, and timelines. These factors and forces can cause complacency, hesitation, and reluctance on the part of board members. However, in the end, there are no reasons that justify ignoring the task. In short, it's difficult and can be messy work—but it is critical and must be managed.

Walt D'Alessio, who currently serves on such boards as Exelon Corporation (lead director), Independence Blue Cross (chairman), Brandywine Realty Trust (chairman) and Pennsylvania Real Estate Investment Trust (lead director), sees board involvement in CEO selection not as something board members should approach kicking and screaming, but an involvement driven by their own convictions.

I don't recall a time when board alignment with the company was more important than today. We need to have more communication and review of business strategy. We need to do a better job in selecting and grooming successors. The difficulty lies in all the other priorities facing boards and companies today. The other reason is a dynamic I see on every board I sit on—directors are fearful of stamping an expiration date on the forehead of the incumbent CEO and creating unnecessary horse races among executive team members.

The business environment has undergone a huge transformation over the past several decades—from the simplicity of commerce in the mid-twentieth century, to the market expansions and consolidations of the 1980s and 1990s, to the global interconnectedness of the current era. Because the intricacies involved in selecting a CEO have increased with each passing decade, the mindset of the past

and the methods previously used will no longer guarantee success in today's business climate.

Our global age requires a new kind of leadership, an alignment of the board and the CEO on all business issues, and the continuous development of talent to ensure continuity of leadership and sustained business success. If properly attended to and thoughtfully executed, CEO succession can offer a company far more than the transitioning of its top leader. CEO succession can enable companies to envision new opportunities for growth, to realign and strengthen processes and systems throughout the enterprise, and enliven and unite employees with new hope and greater confidence.

As we will discover in Chapter 2, many companies have strengthened their CEO succession plans and processes to keep pace with the changing business landscape. They have made succession a business priority and found ways to contend with the undercurrent of powerful psychological forces embedded in the process. These companies have succeeded in transitioning their top leaders and have grown their enterprises as a result.

There are equally as many companies that have failed at succession. For many, the results are immediate, with the loss of stock value and the exodus of key talent. For others, the negative impact on their market position, operations, and ability to retain crucial talent will unfold in the years to come. There is hardly a more crucial process for an organization's continued health than CEO succession.