McKinsey&Company

FEBRUARY 2010

McKinsey Quarterly

Planning for your next CEO

It's high time for boards to get succession planning right.

Ana Dutra and Joseph E. Griesedieck

When Ken Lewis announced last September that he would be stepping down as CEO of Bank of America, he declared it was "time to begin to transition to the next generation of leadership" at the company. There was just one problem: the largely new and recomposed board had not coalesced on a succession plan and had to embark on a CEO search that was resolved only when Brian Moynihan was elected in December. Through this lack of preparation in strategic planning, Bank of America had opened the door to scrutiny and criticism.

The economic crisis—with its imperative to break with the past for a variety of reasons, from new government pressures to disoriented consumers—highlights the perils of neglecting CEO succession. Bank of America was far from alone in doing so. While 84 percent of directors believe that the importance of a CEO succession plan has increased,[1] the sad truth is that only about half of boards actually have one in place.

CEO succession all too often becomes at best an exercise in damage control and at worst an unseemly scramble that can hurt a company and destroy shareholder value. Investors dislike uncertainty, and companies that do not adequately plan for CEO succession leave themselves open to instability, internal politics, rumors, and the potential loss of the highest performers. So why doesn't succession planning get the attention it deserves? For CEOs, spotting the talent that will eventually replace them can be an unwelcome intimation of executive mortality. For boards, bringing up the succession can feel awkward when things are going well. When they are not, it can feel like a threat. But these are excuses, and not particularly good ones.

When CEO succession is a regular, structured process that forms part of the board's agenda, it becomes a matter of routine, no more sinister than the annual compensation review. In fact, boards should view CEO succession as a strategic process intimately related to corporate performance. To that end, succession planning should include not only the CEO's job but also all mission-critical positions in the organization. A company with a fair, objective, and transparent CEO succession process will find it easier to attract and retain top talent and to execute strategy. There will be less jockeying for position and a greater focus on the work to be done.

Planning for CEO succession should begin the day a new CEO starts on the job. While internal candidates are not always eager to be compared and benchmarked, they will accept this process—when it occurs in a consistent and objective manner—not only as a fact of life but also as part of their own career-development plans. The committee responsible for managing the succession process (usually the nominating and governance committee) should every year, and preferably twice a year, review the status of all internal

[1] According to Korn/Ferry International's 34th Annual Board of Directors Study of Fortune 1000 organizations.

candidates. Its agenda should include a succession update as part of its regular reports to the full board. Succession also should be discussed during the board's executive session.

The committee leading the succession process will generally consist of no more than three or four directors, including the CEO and the board chair if a nonexecutive director holds the latter position. If not, the lead or presiding director should be included. It is also helpful if at least one of the committee members has had experience helping a company manage a high-profile succession process. While the full board ultimately has the responsibility for driving it, the CEO's input, particularly about internal candidates, is important. However, some CEOs have a tendency to favor people like themselves. The CEO of a $2 billion industrial company had been openly grooming his successor for some years, with board support, but changes in the competitive environment caused the board to reconsider the CEO's recommendation. Ultimately, the board concluded that the internal candidate was the best solution, but only after dispassionately analyzing the internal and external talent, as well as the experience and leadership qualities the company would need in its next leader.

Consideration of any candidate, internal or external, should start with unanimous board agreement around the corporate strategy. A company looking to do some significant acquisitions as part of its growth strategy, for example, would require a CEO who is a bold visionary as well as a great integrator. But if the company is planning to focus on its core business, it may value a CEO with deep industry and operational experience.

In any case, what may have made executives successful in the past is not necessarily what will equip them to be effective CEOs in the future. Someone with a great record running units in the United States may not have the cultural sensitivities required for success overseas. A very entrepreneurial person might not be able to manage a complex organization. The key is to gauge a candidate's ability to learn and adapt and not to rely solely on the historical report card. The board and the CEO must therefore agree on the company's future strategy and the competencies it will require and then agree on how they will be assessed and evaluated in the candidate selection process. If succession planning reveals a fundamental misalignment within the senior leadership team, that discovery can be a blessing in disguise if it happens early on.

One Fortune 500 company, for example, engaged an independent third party to interview each of its directors as part of the succession process. It learned that there were diverse opinions among the directors on whether the company should continue to pursue an aggressive acquisition strategy, which had been the primary vehicle for growth, or focus during the next few years on integrating the most recent acquisitions. This finding resulted in an open discussion between the board and the incumbent CEO. In the end, they jointly

Related articles

"Using the crisis to create better boards"

"Making the board more strategic: A McKinsey Global Survey"

"When should CFOs take the helm?"

"Shaping strategy from the boardroom"

agreed that while a near-term focus on integration was critical, the company also needed a measured M&A strategy for future growth, and therefore a CEO with proven competence in M&A.

As a board builds a list of potential CEO successors, there are three components of the process to consider. The first involves looking at internal candidates. Are they progressing as expected? Are they getting the right type of experience? If, for example, an executive has excelled in one part of a company—marketing, say, or manufacturing—is it time to stretch that person by a transfer to a different field? The second component requires looking outside the company to map and benchmark the talent market. How do our people compare? Who might be available? Companies that fail to ask these questions can become myopic, thinking that they have the talent they need when they don't. Third, companies should think the unthinkable. Who would be put in the place of the present CEO in the event of sudden need? Is anyone ready?

CEO succession must be an ongoing process, not a one-time event. The company that waits to find its next CEO only when it realizes it will need one is shortchanging itself, its shareholders, and its future.

Ana Dutra is the chief executive officer of Korn/Ferry's leadership and talent consulting group and an executive vice president at Korn/Ferry International. **Joseph Griesedieck** is the vice chairman of Korn/Ferry International and the managing director of its board and CEO services practice.