

boardroom conversations

Bullet-Proof Succession Planning

Ceo Succession Fiascos

Send A Wake-Up Call To Boards

Chief Executive Officer selection and succession planning are two of the most important responsibilities boards face — and corporate boards not alert to the recently heightened standards for CEO selection may well be courting disaster.

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The volatility of the current marketplace has greatly increased the likelihood, not only that many boards will face a CEO succession, but also that they will have to make the decision under the gun. Without full dress rehearsal planning, they risk making an unfortunate choice of CEO and leave themselves open to coups led by activist investors. When a proxy fight looms, Directors may find themselves with tarnished reputations, trying to defend the indefensible — inadequate board oversight of CEO succession.

No board is safe, not even one with an established CEO, as Canadian Pacific found out when activist investor Bill Ackman came calling to replace CEO Fred Green due to poor performance. Initially, the board asserted that they had followed best practices in succession planning, but in truth they had neglected the core component — having a fully prepared, back-up CEO ready at all times. When Ackman challenged them, they were not prepared with their own successor, and the decision was taken out of their hands. In the end, six board members, including the CEO, agreed not to stand for re-election due to insufficient shareholder support, and Ackman and his six other nominees were elected. Ackman now reportedly has P&G and its CEO Bob McDonald in his sights.

Few other decisions a board makes can have such painful and public repercussions, as the embarrassing departure of Yahoo! CEO Scott Thompson illustrates. Activist Dan Loeb and his hedge fund Third Point demanded three board seats by taking dead aim at the quality of the board's succession planning, citing value destruction caused by five different CEOs in five years. When they turned up an inaccuracy in Thompson's resume, they claimed the board had mishandled the selection

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of Thompson as well as the selection of six directors. In the end, Thompson resigned, Third Point got its board seats, and Loeb got the CEO he wanted, former Google executive Marissa Mayer. In one of the most publicized CEO successions of all time, Hewlett-Packard appointed the outsider Léo Apotheker, former CEO of SAP, apparently without a single board member interviewing him. A year later they fired him — the third of their four CEOs within a six-year period. Not surprisingly, the board was pilloried in the press.

Whatever the emergency that precipitates the need for a sudden change, boards often fall back on having a director step in as interim leader while a search is conducted, as Barclays did recently following the Libor crisis. While this solution may provide a short-term fix, it can seriously delay getting an organization back on track after a CEO's sudden departure. In the case of Best Buy last April, CEO Brian Dunn and Chairman Richard Schulze were both abruptly forced out, and in the absence of

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an emergency succession plan Independent Director Mike Mikan stepped in as Interim CEO — and it was a full five months before the permanent successor, Hubert Joly, was appointed.

Even in atypical transition scenarios, boards should expect to be challenged on any CEO succession decision - or even cross-examined, as in the case of Duke Energy's takeover of Progress Energy. When Duke, after having stated repeatedly that the CEO of the combined company would be Progress CEO William Johnson, abruptly replaced him with their own CEO James Rogers, the last-minute switch was seen as arbitrary — and shareholders sued and the North Carolina Utilities Commission had to step in. The Commission not only questioned under oath the two CEOs, but also — in a truly unprecedented move — called four directors on the carpet. Further, if the Commission doesn't like what it hears, it has the power to rescind the merger. If there is any perception at all that the board is not acting in the best interest of shareholders, it is not too much of a stretch to imagine a day when any director could be similarly hauled before Congress to defend the quality of their succession oversight.

Why are so many boards not sufficiently mindful of the CEO succession planning imperative? We see three key reasons:

Historical lack of outside pressure — Until the recent spike in regulation, not to mention activist investors and alarmed shareholders calling for better governance, the heightened marketplace scrutiny just wasn't there.

False sense of security — The presence of strong internal CEO candidates may have lulled some boards into complacency. Boards believe they have checked the box on succession planning by designating one or two internal candidates. But there is no guarantee that those candidates will be ready when the transition comes — especially if it is an emergency change — or even that they will still be at the company, as CEO-ready successors are in high demand in the broader market. And without benchmarking the internal candidates against the gold standard in the external marketplace via the objective eye of an outside party, all a board really knows is that it has the best internal candidate.

Board inexperience — Many Chairs have handled no more than one CEO succession in their careers, if any at all, and the same is true of the majority of Fortune 500 board Directors.

Despite these well-publicized examples of boards finding out the hard way exactly how vulnerable they are on CEO succession planning, many boards are not yet awake to the danger. The days of focusing exclusively on internal candidates without benchmarking against external candidates are gone, as is the common practice of letting the current Chair/CEO lead the process and influence the recommendation. And boards with no plan for an emergency successor in the event of the CEO's death or sudden departure are clearly tempting fate.

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Against that day — or the day they face an implacable, deep-pockets activist across the table — boards should adopt succession planning processes designed to stand up to the harshest scrutiny. While a bullet-proof process doesn't guarantee immunity from attacks by activists or action by regulators, it does diminish their likelihood, because a rigorous process will yield a better choice of CEO in the first place and less unhappiness on the part of shareholders later. Further, in a proxy fight, many shareholders are looking for a good reason to support the incumbent board. An impeccable succession planning process provides one of the best. It also provides an eminently defensible position in the court of public opinion, where battles with activist investors and aggressive regulators inevitably play out — and where board members' professional reputations, for better or worse, may be indelibly rewritten.

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