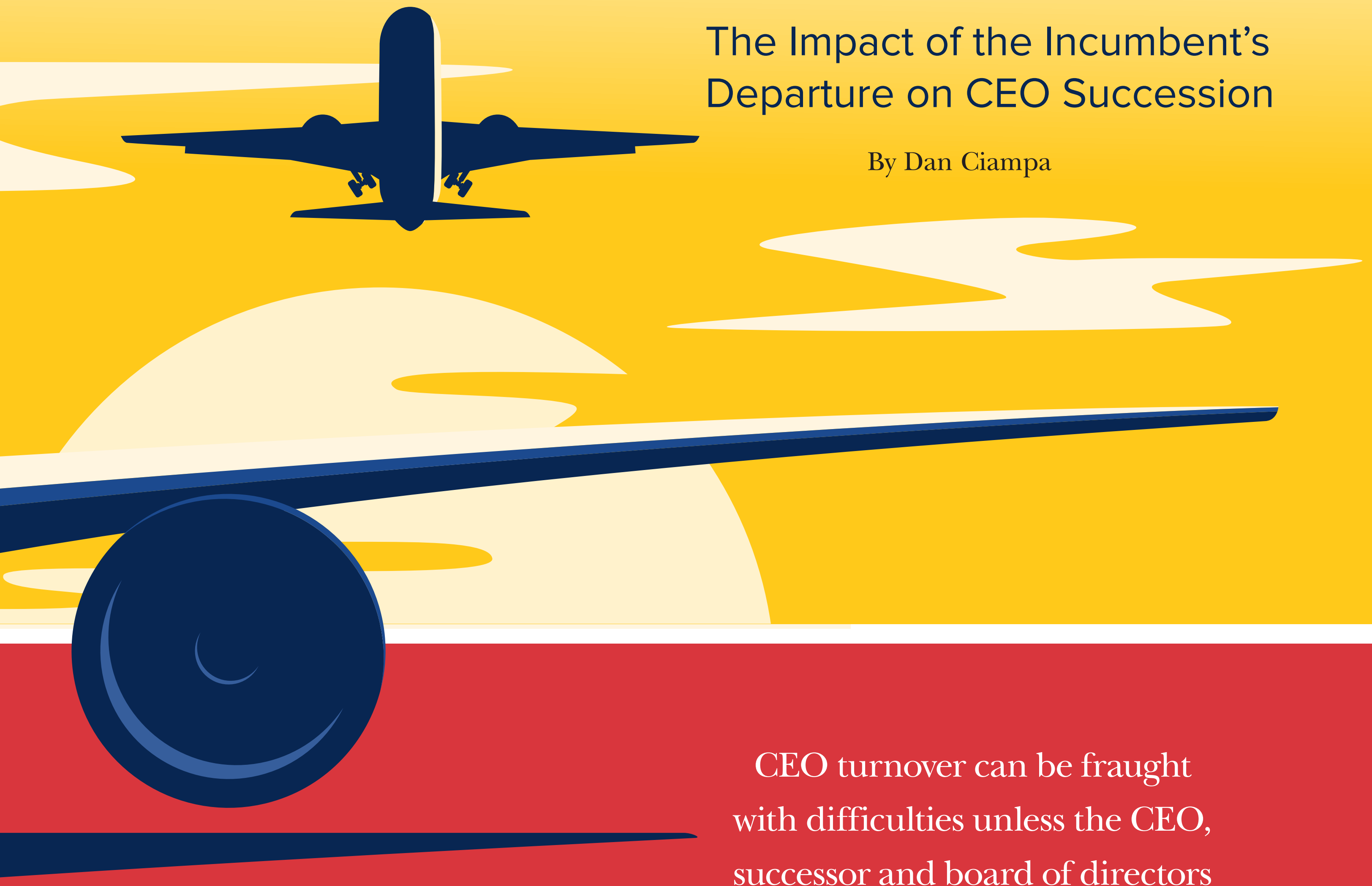
The Art of Leaving

The Impact of the Incumbent's Departure on CEO Succession

By Dan Ciampa



CEO turnover can be fraught with difficulties unless the CEO, successor and board of directors all work together to ensure a smooth handoff.

The pace of CEO turnover is at a high point. Normally, 10 to 15 percent of companies replace their CEOs each year, but in 2018, almost 18 percent of CEOs stepped down. And, they are not staying as long. In 2000, the average CEO tenure was eight years, down from over nine in 1995; but, since 2010, it has dropped to five years.[1]

It seems these trends may continue, at least if the conversations I've had with CEOs over the past few months are any indication. After navigating the stormy, uncertain waters of the pandemic, most said that 2020 was the most difficult year in their careers, taking an unusually high toll on their energy and resilience. More telling, they said they're more frustrated than ever with their boards because the directors haven't appreciated the toll it took on their organizations and on them.

Getting the right replacement for any key manager is tricky, but doing so for the CEO is the most difficult challenge because it is the organization's most complex position and has the most far-reaching impact. The upshot is that the well-being of every employee, customer, supplier and shareholder depends on what boards are supposed to do—ensure leadership stability.

Given the stakes, it would be logical to assume that boards of directors would try hard to excel when it comes to CEO succession. In fact, results of their succession responsibilities would suggest that many boards are not trying at all.

Financial performance of companies under new CEOs is often problematic, especially when they take over from long-serving predecessors. About 20 percent of leaders in place at least 10 years kept their organizations in the upper quartile of total shareholder return (TSR), but their successors perform in the upper quartile only 12 percent of the time. Conversely, a third of successors perform in the bottom quartile compared to 10 percent of long-serving CEOs.[2] The cost of these failures is significant. One study estimates the amount of market value wiped out by badly managed CEO and C-suite transitions in the S&P 1500 is close to $1 trillion a year.[3]

Of course, CEO succession isn't easy. The personal characteristics that matter the most (such as maturity, character and ability to influence) are hard to judge before someone is in the top job, and reactions and support of key direct reports are unpredictable. Also, since each handoff has to be tailored to the culture and to the political context of each company, boards must put in the time for a good result. But most don't. A study from Stanford University found that only 54 percent of boards were actively engaged in developing a successor to the CEO, and 39 percent had no viable manager to step in to replace the CEO in an emergency.[4]

CEOs end their tenures in one of four ways. Poor health is one, but CEOs step down for this reason less than five percent of the time.[5] A second is the result of an acquisition, accounting for about 11 percent of transitions.[6] Much more often, CEOs are either forced out by the board or leave through a gradual, planned succession process.

About 20 percent are forced out because of poor performance.[7] While poor financial performance might seem the likely reason, one study showed that only a small percentage of CEOs of underperforming companies are replaced by their boards.[8] Rather, leaders are fired more often for reasons such as mismanaging the culture, poor relationships with the board and, increasingly, for ethical lapses.

The most common way that CEOs are replaced is through a planned succession process after agreeing with the board on a departure date. Sixty-eight percent of all handoffs are handled this way.[9] In addition to being the most common, it also has the best financial results. When a successor gains the top job this way and stays in the role, the company's TSR tends to be higher.[10]

The bad news is that, in a large number of cases, CEO handoffs are not successful for either the company or the successor. Forty percent of new CEOs fail to meet performance expectations in the first 18 months.[11] Why do successors fail?

CORE REASONS FOR FAILURE

Reasons for failure generally fall into three categories.

1. One is because the successor fails to build support due to lack of early successes, being ineffective at influencing or not building the right relationships.[12]
2. A second reason is that the succession process is mismanaged, perhaps by waiting too long to initiate it or mishandling the search.
3. The third reason has to do with how the incumbent CEO hands off the mantle of authority to the successor, including their relationship.

The incumbent's departure has largely been ignored. An exception was Jeffery Sonnenfeld's useful *The Hero's Farewell* from 1988. While it explored the emotional difficulties of CEOs leaving after successful careers, its purpose was not to also link incumbents' exits to important succession issues like the responsibility of boards or the relationship between predecessor and successor. The goal of this article is to shine a light on the impact on succession of how the incumbent leaves.

The next section describes three case studies of actual transitions (although company and individual names have been withheld for confidentiality) identifying common dilemmas as CEOs exit.

KEN
Good Intentions, Poor Execution

Ken had been hired from outside the industry as chairman and CEO after the board realized the company had become too complex for the founder. The directors recognized the rare combination of abilities needed to get the company growing and on a better path: strategic plus solid operational skills; intense drive plus high levels of maturity and self-awareness; and sensitivity to the company's culture plus awareness of how major change might damage it. They believed he'd move fast to solve problems while avoiding being reckless. He didn't let them down.

In his first year, Ken gradually reset the company's key direction. He redesigned core processes, introduced a more analytical decision-making style and invested in technology. Talent was imported, people who could keep up were promoted and ones who resisted change were let go.

Eight years later, what had been a middle-tier, regional presence was the most profitable, fastest-growing company in its industry. It had become the leader in quality and innovation, and a magnet for high-potentials looking to develop their management abilities. Recognition from competitors and customers had been matched by investors' enthusiasm as the share price increased tenfold over what it had been when Ken joined.

Entering his tenth year as CEO, Ken had every reason to be the happiest person he knew. He was the most powerful leader in his industry, his net worth was higher than he'd ever dreamed it would be, and the business showed every sign of continuing its run of success. He was surprised to find himself feeling less satisfied and more restless. He realized that he'd accomplished all he could in this company. He had no hobbies and was too young to retire. He wanted to take over another company and do it again.

After the board gave up trying to talk Ken out of leaving, it agreed to his plan of promoting a subordinate to CEO with Ken staying for a short transition period of six months, then leaving entirely as the lead director moved to board chair. That's when things began to unravel.

What followed was a period of internal turmoil and stress. The designated successor, while talented operationally, wasn't ready to lead the company. He hadn't mastered Ken's complex strategy, had little investor relations experience and had never managed board relationships. The directors became concerned when he appeared unprepared at the first board meeting after the announcement and, worse, failed to impress investors in the next earnings call. Shortly after, the talented CFO announced he had accepted a position in another company. Ken decided he had to stay as CEO for at least another year. That decision caused the designated successor to begin looking for other opportunities.

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WALTER
Never Wanted to Leave in the First Place

Unlike Ken, Walter never wanted to leave his post as CEO at the company where he'd spent his entire career. He was 62 when the board raised the topic of succession. The chairman had said that the board wanted to have an external search find a successor by the time Walter turned 65; Walter agreed, but immediately regretted it. The company had been Walter's whole life and the prestige of being CEO was important to him. He was uncomfortable with conflict, avoiding tough conversations whenever possible. If he was patient and maneuvered in the right ways, eventually he'd get what he wanted without having to get himself or other people upset. He knew he'd find a way to keep his job until he was ready to leave.

The board hired a search firm where Walter had no contacts to apprise him of progress. There were brief updates at every board meeting, but Walter figured he had time to influence the board and concentrated instead on running the business. He was surprised when the chairman told him that three final candidates had been chosen and it was time for Walter to be involved.

The search had produced one candidate who wanted an immediate CEO title; the chairman told Walter that he might accept a short transition period, and, if Walter was ready to leave, the board would reward him generously. The second candidate, currently a COO, would not come without a guarantee that she'd be named CEO by the annual meeting eight months away. The third was a division president who was willing to enter as the COO and gradually assume more responsibility until being named CEO within three years. Walter, not surprisingly, supported the third candidate, and he was hired.

Michael started three months later; and at first, Walter seemed to embrace him, giving responsibility more quickly than the board had expected, including letting him take the lead on a large acquisition. His first year produced record growth, partly because of the acquisition and also the cost discipline Michael introduced. Even though Walter recommended a modest increase, the board rewarded Michael with stock options and an above-target bonus. Year two of Michael's tenure was less positive. Synergies from the acquisition were slow to materialize which, combined with the aggressive cost savings of the first year, negatively affected performance.

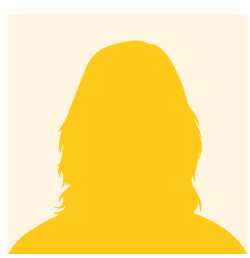
The most striking change, though, was Walter's support. He became openly critical of Michael's decisions, and told the board he intended to get more involved in the day-to-day running of the business, something the board argued against. Walter agreed reluctantly, but said he'd rein him in a bit.

During his first year, Walter allowed Michael a lot of freedom, a supervision style to which he responded well. Now, when Walter asked for more frequent and detailed reports, tension between them surfaced for the first time. But, Michael, staying focused on being CEO, remained patient in the face of Walter's intrusions. He also adjusted his management style resulting in deeper support from influential subordinates, and a second record year. The board again rewarded Michael handsomely.

Michael, understandably, believed he'd passed every test and began pressing Walter about when he'd be given the CEO title. At first, Walter was noncommittal, then evasive. Michael, worried that Walter had changed his mind about leaving, made the mistake of encouraging his subordinates to mention to Walter what had been accomplished since he joined and then compounded the problem by going around Walter to the chairman to ask about the pace of the transition. When he learned of both, Walter accelerated his criticism of Michael and the distance between the two made everyone at the senior level anxious.

The chairman and the other independent directors became convinced that without a guarantee of becoming CEO by his third anniversary, Michael would resign. The board told Walter that it wanted him to step down, a decision he seemed to accept. He left on schedule as Michael became CEO.

Over the next two years, Walter did not interact with Michael but maintained his relationships with several board members. He remained a large shareholder in the company and when the chairman retired, Walter publicly suggested that the company was not growing fast enough. Months later, it became apparent that a private equity firm known for its hostile tactics had begun buying shares in large numbers. Eventually, it gained a board seat and with other planned director retirements, the makeup of the board changed dramatically. Within three years of Michael taking over, he was replaced as CEO by Walter.



SUSAN
Charismatic Leader's Triumphal Exit Weakens Instead of Strengthens

Susan was the first woman to become CEO in her industry. She was ready for the role from day one, having developed the right characteristics throughout her career.

In college she minored in drama, excelling on the stage, and entertained thoughts of becoming a professional actress.

Convinced by her father to go to graduate school first, she earned an MBA followed by a job in a top strategy consulting firm where, she says, her "hobby was to write case studies in my journal of the clients who motivated their people so well that they did extraordinarily innovative things." She also adapted performing skills to presenting complex analyses and recommendations in ways that were more effective than most of her colleagues, and within a couple of years, was leading the firm in selling new projects.

Susan left to become chief of staff to the CEO of a large consumer products company. Two years later she became a regional sales executive. In five years, she became SVP Sales, and was then promoted to EVP Sales and Marketing. Four years later the CEO engineered an acquisition of a mid-size company and named Susan division president. After five years, she was brought back to corporate as Chief Operating Officer. Five years after that, at 52 years old and after 25 years in the company, she became CEO.

The company she inherited was well run, strong operationally and efficient. Susan understood that fiscal discipline enabled reliable returns to investors but as revenue had gradually slowed competitors made inroads through better brand management and new products. She recognized that the marketplace was changing in ways her bosses had ignored. She became convinced that success in the future depended on investing in innovation rather than reliance on efficiencies.

It was a company where managers were hard working and competent, but not inspiring; a gap Susan quickly recognized as a way for her to stand out. In each of her management roles, Susan worked hard to develop her charismatic abilities, which in turn resulted in intense loyalty from employees and overachievement. Most charismatic leaders are associated with periods of strategic and cultural change. Both emotions and stress are at high points, and followers are attracted to a leader, particularly a new one, who describes an exciting image of a better place in which they can envision themselves. Susan excelled at such a challenge.

She'd set her sights on being CEO for a long time, carefully constructing her culture-change plan and inspiring employees to perform in new ways. During her eight years at the helm, the company produced some of the industry's most innovative products, consistently won market share from larger, better financed competitors and built a model culture studied by other companies. The results and her leadership style made Susan a celebrated, widely admired businesswoman.

Now, eight years later, she decided it was time to begin the process to pass the baton to her successor. She'd achieved everything she set out to do strategically and culturally, emphasizing innovation in every aspect of the business. She'd always intended to leave at the peak and on her own terms, controlling every aspect of her exit, something she knew the board would allow.

Her successor, also from the sales and marketing area, was a younger version of Susan—smart, tough and charismatic. Responsible for some of the company's biggest marketing successes, she was as accomplished as Susan at influencing people whose cooperation she needed.

The transition part of the succession process went just as Susan had intended. With the company at the apex of profit, market share and reputation, the board, shareholders and employees all expressed appreciation for what she had done. She exited a hero. Within two years, though, the situation had changed quite a bit.

Industry shifts that had been taking shape quietly toward the end of Susan's tenure accelerated, starting with a merger of two competitors to form a larger and more powerful competitor. After more consolidation and significant realignment, a competitor's new product that posed a direct threat to the company's most profitable area surprised Susan and her senior managers, leaving the company flat-footed.

Soon after Susan's successor took over, two senior managers who'd hoped to win the job left for other companies, which led to several departures of high-potential mid-level managers. To compound the problem, some of the promotion and hiring decisions made to replace them were mismanaged, causing more turnover in key positions. Then, a new product, expected to be the next big win, had a tepid introduction causing financial performance to suffer and the share price to slip.

The upshot was turmoil at a time that demanded coordinated reaction to external changes. Three years after Susan had left her company at its height, it had fallen to number three in the industry and faced an uncertain future, with investors unhappy and a culture that needed more than inspiration.

THEMES

What are the lessons to be drawn from these examples? Let's look at each.

Ken

Ken's succession failed because he rushed into the transition with a successor who had many strengths but was not well-enough prepared for the office he'd inherited.

Ken had managed board relationships very well, but, other than presentations at meetings, he'd not encouraged contact between most of his subordinates and the board. The same was the case with investors, where interactions were limited to answering questions during earnings calls. The one exception was the CFO, but when he left, Ken's successor was unprepared on both fronts. The only person he could turn to for help was Ken, but by the time he became CEO, Ken was concentrating on his next challenge and not very available.

In addition, Ken hadn't taken into account differences in how he and his successor approach problems and decisions. Ken assumed that once he became CEO, his successor would operate as Ken had—get something started and then adjust on the fly, a style that demands real-time analytical skills as well as experience. The successor, who is confident in the path forward after intense analysis and considering all possible contingencies, is a systematic, deliberate decision-maker compared to Ken's instinctive, intuitive style. When the successor made no changes to the information and decision-making system geared to Ken's style, he found himself unprepared. The result was three problems that hinder a new leader's success: loss of time (by having to translate or restate information); loss of momentum (from limited early wins); and, more serious, loss of confidence (both his own and his direct reports).

Because of how he'd redesigned the company, Ken was the only one who knew the key levers and how to use them for the right results. Instead of leaving abruptly, he should have stayed as CEO a bit longer to coach his successor, which the new CEO would have welcomed. Then he should have become non-executive chairman and made himself available as a sounding board.

Of course, a contributing factor was that the board was not as involved as it should have been. Ken handled succession as he had most of the major events—while he communicated with the board regularly and filled it in after the fact, he tackled big bets on his own and with his key direct reports.

The board allowed this style, perhaps reasoning that as long as financial results were good, Ken could operate any way he wanted. Or perhaps it was due more to self-interest. Because of the stock's appreciation, they'd made a lot of money and were reluctant to do anything that would hinder that value.

Walter

The most glaring reason for the failure of the Walter-Michael succession was that the board didn't deal with Walter's insecurities and the emotional impact on him of leaving the place where he'd worked for so long and that was such a big part of his self-image.

Walter bears primary responsibility for what happened. Instead of being open about his reactions and emotions, and perhaps moving on, he plotted to get what he wanted, but at a high cost for everyone else.

Michael's career was derailed (he eventually became CEO of a smaller company). Turmoil caused managers to pick sides between Walter and Michael, leading to turnover and missed operating plans. More broadly, the company was distracted, affecting its reputation and valuation. Perhaps most damaging was that Walter's plan included a secret alliance with the private equity firm that had won a board seat, which led to the company going private and Walter being re-installed as CEO. It was then bought by a long-time competitor. So, what had been a proud, independent organization became nothing more than a brand name for another company.

The third reason is that Michael had not done as much as he could have to build the sort of relationship with Walter that would have at least neutralized him as a negative force. He allowed his success and the board's attention to go to his head.

I had known him early in his career as he moved up to higher-level positions. One of his more attractive traits was his humility, always avoiding the spotlight, which made him seem more mature than his peers and amplified his accomplishments. This combination of maturity and results allowed him to use his formidable relationship-building skills, particularly with bosses. He seemed to lose those characteristics under Walter, perhaps triggered by frustration that Walter was not going to live up to his commitment to step aside.

At some point during the period before taking over, every designated successor wonders if the predecessor will step aside as planned. Some work even harder toward tangible goals to prove their case for promotion. Others build alliances with people whose support they want. Still others, like Michael, react in ways that cause political problems that threaten their transition to the top.

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Susan

Susan's story is an example of the dilemma of the charismatic leader: strengths that fueled success caused failure in her final CEO test—her own succession. Why did that happen?

Susan ignored a key lesson from her own rise to the top. She'd won the CEO job in part because she foresaw changes in the marketplace that others missed and formulated a strategy to take advantage of them before competitors. Her successor was buffeted by external changes that had taken shape while Susan was still running the company; she should have recognized them and at least coached her successor to respond.

But, Susan acted differently this time for two reasons. First, the administrative system she'd created around her had evolved to avoid giving her bad news. Earlier, it had been anchored by her chief of staff who had highlighted her top priorities. He'd left the company because, according to the head of HR, he'd become frustrated at being told to eliminate parts of reports that contradicted Susan's opinions. The problem wasn't just Susan ignoring objective analysis but that her followers' intense loyalty had "changed the culture so that instead of doing the right thing, people did what they thought Susan wanted."

Secondly, Susan stopped listening to advice. She'd stopped using outsiders who'd provided objective views and feedback, even though at town halls and management development sessions she emphasized the importance of a balanced advice network. Also, direct reports admitted that the senior leadership team had become less of a real team because its members rarely disagreed. Where there had been robust, sometimes heated, conversations leading to the right decisions had become just a group that favored positive feedback and gentle agreement.

Ultimately, this succession failed because Susan chose the wrong person as her successor. Rather than casting a wide net for the best person for the company's needs, she convinced herself and the board that her successor should come from within the company. She'd pointed to data that internal candidates are more reliably successful, but there was a more personal reason for her choice. Susan believed that she would be regarded as a more complete and successful leader if she was replaced by a subordinate as opposed to someone hired to succeed her. This belief, not uncommon among departing CEOs, relates to concern for their legacy.

LESSONS

What lessons can be learned from Ken, Walter and Susan? One is that planned successions must take into account the exit of the incumbent. Another is that there are three major players—the CEO, the board and the successor—each with a unique role that is impacted greatly by the other two. The third lesson is that the right preparation is essential.

James Baker held two cabinet positions, ran five presidential campaigns and is considered by some to have been the most effective presidential chief of staff in history. In con-

BOARDS ARE NOT PREPARED

- Most boards lack sufficient knowledge of the topic of succession, and thus ignore what both incumbent and successor experience as power and authority are passed from one to the other. More directors should be current CEOs (few sitting CEOs are directors of other companies) and/or retired ones who went through their own transitions.
- Most often missing is a practical framework that can be tailored to the strategic, operational and cultural needs of their company. It must encompass both parts of the succession process—the *transition* from one leader to the next and the new leader *taking* charge. Importantly, this second part ends only when the successor has earned the loyalty of influential managers; boards should not declare a success until this point is reached.

CEOS ARE NOT PREPARED

- The power of the incumbent includes substantial impact on the culture, which enables the business' strategy. Most CEOs do not understand how to utilize the culture of their organizations to advance their strategic intent … nor are they armed with a plan to ensure their successors understand and make the most of the culture they are inheriting.
- Most incumbents do not sufficiently consider the effect of how they leave on their successors' ability to take hold. They are used to being in charge, with others figuring out what they are thinking. In their own transition, they must put themselves in the place of those who are succeeding them and strive to understand what they're going through.

SUCCESSORS ARE NOT PREPARED

- A major success factor for new CEOs is creating momentum from early wins in areas vital to the strategy they've inherited.[12] Many successors, particularly when predecessors enjoyed strong loyalty, are unprepared to build a strong relationship with their predecessors and use it to achieve early wins.
- Great CEOs have sharp influence skills backed up by strong relationship-building capability. But many new leaders are chosen for their functional competence without assessing their ability to influence. The wise successor takes over with a plan to win over both predecessor and influential managers.

sidering how to best conclude this article, I'm reminded of a phrase he was known for: *preparation prevents poor performance.* It applies to each of the key performers in the CEO succession drama because experience in this area as well as the data suggest that in many cases, none of them are sufficiently prepared for CEO succession.

While all three actors in this drama must sharpen their ability to bring the audience to its feet cheering, the board stands out as having to improve the most. Harry Levinson wrote a *Harvard Business Review* article in 1974 titled "Don't Choose Your Own Successor," pointing out that while many reasons exist for failure of new CEOs, the main one is the predecessors who chose them. It was an era when CEOs had a lot of power, aided by rubber-stamping boards. Times have changed. Today, the reason for so many new CEOs failing is the boards that chose them.

Dan Ciampa is a former chairman and CEO, an advisor to boards and chief executives, and the author of five books, including *Transitions at the Top: What Organizations Must Do to Make Sure New Leaders Succeed* (with D Dotlich, Wiley, 2015) and *Right From the Start: Taking Charge in a New Leadership Role* (with Michael Watkins, Harvard Business Review Press, 1999).

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