

Managing CEO Succession

Business leaders who achieve extraordinary short-term success for their companies often get the most attention; but how does a company achieve long-lasting success and value for its shareholders? How does corporate performance correlate with CEO leadership over an extended period?

A new study by Indiana University’s Kelley School of Business and Fred G. Steingraber, Chairman Emeritus of A.T. Kearney and Chairman of Board Advisors, sought to answer these questions. Research based on S&P 500 companies found that the 36 non-financial companies with exclusively “home-grown” CEOs—those developed and selected from within their ranks—consistently outperformed the remaining companies that went outside for their CEOs.

The following outlines some of the main findings of the joint study:

Companies with home-grown CEOs lead in nearly all metrics. The companies with home-grown CEOs outpaced other S&P 500 firms in a wide range of metrics covering company returns, growth, margins and share appreciation (*see figure*). The study showed that well-managed leadership succession ranks among the most important duties of a board of directors.

Research shows that inside CEOs fare much better at instituting strategic change that lasts. Outside CEOs, on the other hand, are typically good at short-term cost-cutting, but struggle when those opportunities dry up. They are also more likely to strive for unrealistic goals, take excessive risks and make decisions based on flawed assumptions.

Succession planning remains a top challenge. Estimates suggest that only about half of

FIGURE

Non-financial S&P 500 performance analysis, 1988-2007 annualized results

Study group	Description/ number of companies	Returns			Growth		Margin	Share appreciation
		Return on assets (ROA)	Return on equity (ROE)	Return on investment (ROI)	Revenue growth	Earnings per share (EPS)	Profit margin	
Group I	36 non-financial S&P 500 firms, 100% home-grown CEOs	9.5%	20.3%	13.3%	11.9%	13.9%	7.9%	16.7%
Group II	S&P 500 firms, excluding Group I and financial companies*	4.9%	15.8%	8.2%	4.4%	4.6%	6.0%	12.7%
Group I average annual performance multiples over 20 years		179.2%	125.3%	152.8%	238%	253%	129.5%	127.4%

* The total number of non-financial companies in the S&P 500 in Group II varied from year to year depending on the number of financial companies, but ranged between 375 and 400+. Source: Kelley School of Business at Indiana University study, 2011

public and private corporate boards have CEO succession plans in place, and only 16 percent of directors believe their boards are effective at CEO succession planning. Even more disturbing is the finding that of externally recruited CEOs, 40 percent last two years or less and 64 percent are gone within four years. Externally recruited CEOs also cost 65 percent more than those recruited from within.


Top performing companies have fully engaged boards and effective processes.

A key component of the talent-pipeline process is the directors' regular access—both formal and informal—to internal talent. A variety of practices can help prepare potential leaders, including experience in multiple roles, mentorship and performance assessments.

The key is finding the proper fit. One reason so many successions fail is that outside CEOs do not fit into the organization's culture well enough to do what is needed. Some compa-

nies have wisely introduced rigorous assessment programs—beginning early in a candidate's career—into their leadership-screening processes. Down the road, a nominating committee can help focus energy on choosing the right candidate. Additionally, engaging the incumbent CEO in the process can make a huge positive impact, since the CEO knows as much about the firm's culture and day-to-day realities as anyone. Of course, this is not easy on many levels, even for the best CEOs and organizations.

A Process, Not an Event

CEO succession is too often seen as an event rather than a process. Research confirms that strong board involvement and robust internal succession processes are vital for long-term sustainability. While bringing in a “rock star” CEO may grab the headlines for a brief time, it's those home-grown leaders who more often produce the best and most enduring results. 

For more information, see “‘Home-Grown’ CEO: One key to superior long-term financial performance is managing leadership succession” at www.atkearney.com, or contact Fred Steingraber at fgs@board-advisors.com.

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