LEADERSHIP TRANSITIONS

The Secrets of Great CEO Selection

by Ram Charan

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Nothing good comes of having the wrong CEO. Mentoring, coaching, senior team members with complementary skills, and special help from the board can't compensate. The misses are devastating—and very public. Yet some boards still pick chief executives who aren't right for the job—repeatedly. The revolving doors at HP before Meg Whitman, at Apple before Steve Jobs's second tenure, and at Yahoo during the past decade are only a few of many recent examples.

On the other hand, I've seen some surprising CEO appointments that turned out extraordinarily well, such as Lou Gerstner at IBM, Alan Mulally at Ford, and Steve Jobs in his return to Apple.

Why are some boards great at hiring company leaders, while others struggle? For more than three decades, I've been involved in CEO successions in the United States, China, Japan, India, Brazil, and Europe, as a director, an adviser, or a member of the selection committee. I've observed firsthand situations in which the board made a terrible choice, and I've worked with boards that were extremely skilled at selection and whose choices created enormous value. Throughout the years I've noticed that great succession decisions were really driven by one or two directors, whose judgment and expertise the board relied on, and I've worked to distill their common approaches and "mental algorithms."

In my experience, board members who are adept at picking CEOs do four things others don't: They work painstakingly to clarify the essential qualities needed to succeed in the job; they keep an open mind about where the best candidate will come from; they go deep to understand which candidate is the best fit; and they allow for imperfections in the chosen candidate.

Rigorous succession planning is essential. But it takes you only so far. Eventually a decision must be made, and when it comes to choosing among two or three final candidates, judgment really matters. Here's what directors that excel at it do to make sure their judgment is sound.

Finding "the Pivot"

Boards should always have a viable pool of CEO candidates and, in case of a sudden succession crisis, a so-called name in the envelope. But when the moment of truth is imminent, directors who make great CEO picks set those lists aside. They start by understanding the current and future requirements of the job, zeroing in on the critical capabilities that will make or break the company. The result is not a laundry list of leadership traits any CEO should have, nor is it a single item. It's a strand of two or three capabilities that are tightly interwoven and required for the new leader to succeed. This is what makes the decision turn toward one candidate over another. That's why I call it "the pivot."

When you're choosing the final candidate, judgment about the fit matters.

Each situation is distinct, and so is each CEO job's pivot. It's important to identify the pivot in very specific terms—and to get it right. Consider the retail industry. Today legacy retailers need leaders who can credibly go up against Jeff Bezos and Amazon. Their pivots should include the ability to focus on the end-to-end consumer experience, deep familiarity with digital innovations (such as in-store geotracking and digitally driven logistics), and the ability to shape the retailing ecosystem of vendors and delivery services. A legacy entertainment company, in contrast, might need a CEO who can amass digital properties, create a team that will use streaming and algorithms to put the company on offense, and make the necessary shifts in people and resources. For a traditional automotive parts supplier, the pivot might include sufficient knowledge of technologies OEMs are using to engage in discussions about industry standards and direction, the ability to build advanced technology into the organization's core competence, and skill at partnering with upcoming digital-born companies.

Directors who choose the right CEOs do a lot of work before arriving at the pivot. They take the time to fully understand the company's current challenges and how the external context is changing. They read analyst reports, talk to insiders, and consult outside experts to expand their thinking. They go both broader and deeper than board members typically do. They don't dismiss complexities or contradictions; they cut through them and deduce what skills and capabilities are essential, iterating until they hit on the right combination.

Take Tom Murphy, former CEO of Capital Cities/ABC, and the late Jim Burke, former CEO of Johnson & Johnson, who tapped Lou Gerstner to take the helm of IBM in 1993. IBM was failing at the time, and the outgoing CEO had already announced its imminent breakup. Directors Murphy and Burke spent a month visiting customers and industry experts around the world, listening to their issues to better understand what was happening externally. What they learned convinced them that the company's problems were more business-oriented than technological. They didn't rule out CEO candidates from the tech industry, but they saw that tech company experience was not the most important thing. As the business press hotly debated which technologist the board would ultimately choose—a *New York Times* article titled "Help Wanted: Computer Skills a Must" named John Sculley from Apple, Ben Rosen from Compaq, and George Fisher from Motorola as likely options—the IBM directors turned elsewhere. The pivot they were looking for was a mix of proven business acumen, customer orientation, and the ability to make a large organization more decisive and accountable.

The position was first offered to Jack Welch, the celebrated CEO of GE, whose business acumen and ability to deliver results were legendary. When he declined, they asked if GE would buy IBM. No again. Then they turned to Larry Bossidy, a Welch disciple who had demonstrated the skills they sought as vice chair at GE and as head of AlliedSignal. After he rejected them, they reached out to Gerstner, a marketing whiz who had delivered a decade of profitable growth at American Express. Having left Amex when he hit a ceiling there, and not quite liking his new post as CEO of RJR Nabisco, Gerstner was game for the challenge. And as history shows, he rose to it.

Within weeks of taking the job, Gerstner diagnosed IBM's problems. The mainframe business wasn't dead; it had a bloated cost structure, and the pricing was wrong because the company didn't have the right people setting it. IBM didn't need to be broken apart; on the contrary, its ability to give customers a single access point for a mix of offerings was a competitive edge. Gerstner knew this from his years at American Express, a longtime customer of Big Blue's. He could also see that IBM needed to shift away from hardware toward software and services, allow compatibility with competitors' products, and reduce its bureaucracy so that it could execute better.

Gerstner acted quickly, announcing plans to cut prices by roughly 30% and costs by some $7 billion. The results were almost immediate. By the third quarter of 1993, solvency was no longer an issue, and by 1994 the bottom line had swung from an $8 billion loss to a $3 billion profit. The stock price doubled in less than three years. The firm's performance continued to improve year by year, creating enormous value, and IBM became a leader in U.S. business and in the global technology industry once again.

Clarity about the pivot also helped Apple get back on track after it ran into trouble in the 1990s. One morning in 1997, I got a call from Ed Woolard, the former CEO of DuPont who had just become Apple's lead director. In the 12 years since Steve Jobs had been pushed out, the company had suffered a string of disastrous product releases and seen its market share erode, and bankruptcy was becoming a distinct possibility—the sad result of three consecutive failed CEO selections. Woolard and I had worked together for many years. He wanted me to find out if Michael Dell was interested in purchasing the company.

The response from Dell was a flat no. Dell, in fact, would later tell a crowd of several thousand tech executives at the ITxpo97 that Apple should just shut down completely and give its shareholders their money back. Nobody—not Compaq, AT&T, or IBM—wanted to buy the company.

Apple's one last chance, Woolard figured, was a new CEO, and he began to ponder what the job would really require. The company had a soul, an exceptional brand, and a large contingent of die-hard customers even though it was in decline. Apple products were higher-end and higher-priced, and customers loved their ease of use and aesthetics.

Woolard identified the pivot: Apple needed a CEO who was imaginative with a flair for creating a highly differentiated experience that consumers wanted. The CEO had to be an innovator and a game changer. Searching for candidates who fit that description, he called me again. "Do you know of anyone?" he asked. I didn't. "What do you think of bringing back Steve Jobs?" he asked.

Jobs's mercurial behavior was legendary, and NeXT, another company he had started, had floundered. But his third venture, the computer-animated-film pioneer Pixar, had pulled off a highly successful IPO. As we talked I could see that Woolard's instincts were right: Jobs had a strong innovative streak and a feel for the consumer.

Woolard stayed in close touch with his fellow board members throughout the process, sharing with them the data he gathered on how quickly the company was deteriorating. They eventually came around to fully backing the move to replace the incumbent CEO with Jobs. They even agreed to give up their board posts—a condition Jobs imposed. To ensure a smooth transition, Woolard became a mentor to Jobs, so much so that when Jobs called Woolard's home and Woolard's wife answered, she would call out, "Ed, your son is on the phone!"

We all know the outcome of the decision to bring Jobs back. The iPhone and the iPad are among the blockbuster innovations that followed, and Apple became the world's most valuable company, in part because its lead director understood the pivot.

What if you get the pivot wrong? Consider what happened at a large Chinese real estate company. Its chairman was a bold thinker with ambitions to grow quickly. He bought a lot of land by borrowing heavily and built offices and apartments at a very fast pace—too fast for the market to absorb. Quality was slipping, inventory was piling up, and cash flow was increasingly negative. Meanwhile, tensions were rising between headquarters and the field.

As he set out to hire a CEO, the chairman remained squarely focused on executing his growth vision, raising substantial funds from Hong Kong, and preparing the company for an IPO within two years. He hired an experienced leader with great contacts in Hong Kong who promised to raise the necessary money and ready the firm for the public offering.

Four months later it was clear that the CEO could not deliver the funding, and the internal problems had worsened. The chairman removed the CEO. He then revised the pivot: The company needed someone who could sell off inventory, cut costs, and get project managers to work with headquarters to generate cash. The IPO could wait. Shortly thereafter he hired a new CEO, who in his first few months improved execution by an order of magnitude and turned the cash drain into cash reserves.

Keeping an Open Mind

When drafting the final short list of candidates who might fit the pivot, skilled board members start with a clean slate. They realize that in a fast-paced business world, a company's needs can shift suddenly and the entire set of candidates their succession plan identified may now be irrelevant. They back off from longtime favorites and keep an open mind. They battle against hidden assumptions and biases—their own and other people's—as they home in on two or three prospects and, ultimately, a final choice.

Of course, at companies that take succession planning seriously, directors make a point of getting to know the company's top leaders over time. They observe them during boardroom presentations, talk with them over cocktails and dinner, and sometimes make site visits, where they see the leaders working with their teams. But along the way, directors often develop favorites, especially if they've coached someone in the succession pool. Those psychological bonds can be hard to break.

I've seen directors form definite opinions about a person in their first encounter and never change their views, be it positive or negative, even in the face of lots of contradictory evidence. I saw one director advocate for a particular individual who clearly lacked an important capability the board had agreed on, because he had been impressed by the sharpness of the person's boardroom presentations early on.

> **Directors should be willing to look at leaders a few levels below the CEO.**

Directors who are great at selection strive for objectivity as they review candidates. They don't take the existing front-runners or the CEO's recommendations as a given. And they don't assume an insider or outsider is best. Many boards use headhunters to add a few external candidates to the final list, if only for the sake of due diligence. (That step shouldn't be perfunctory; the search firm has to understand the pivot so that it doesn't offer up just the usual accomplished CEOs.) When considering outsiders, astute CEO selectors don't let themselves be unduly influenced by a candidate's celebrity or the halo effect of having worked at a marquee company.

Ivan Seidenberg, the former CEO of Verizon, who is a veteran of more than half a dozen boards, including those at BlackRock, Boston Properties, Honeywell, and Wyeth, is decidedly good at picking CEOs. He has noted a recent trend toward thinking that only an outsider can do the CEO job. In my experience some directors go the opposite way, always favoring insiders. Seidenberg avoids such foregone conclusions. As he neared his own retirement, he made sure he gave the board lots of exposure to the handful of internal leaders he saw as top contenders. "My point was to give the board options," he recently told me, "so the board would feel comfortable with its decision, whether or not it decided to go outside. I always tried to keep the process dynamic."

Sometimes it's assumed that leaders must report directly to the CEO to be in the running. But directors who excel at selection are willing to expand the lens, to look at leaders a few levels below the CEO. Especially in this digital age, years of experience probably matter less than they once did, and they could even be an impediment to necessary change. We've seen many examples of leaders below the age of 35 who grew their leadership skills as fast as their companies, from Michael Dell and Bill Gates to Mark Zuckerberg and Larry Page. Frank D'Souza, who put Cognizant on a tear, was 38 when he was named CEO.

Finding the Fit

When you're down to the final few potential successors, each will have passed multiple filters and is likely to be a highly accomplished leader. Savvy CEO selectors go deeper than most to understand how well each person matches up against the pivot. They create a complete and accurate picture of each candidate to determine not the best leader but the best *fit.*

Of course, interviews between directors and final candidates are standard at many companies, but in my experience there is startling variation in the depth of those conversations. One way to be more thorough is through a mechanism I saw the search committee of a large midwestern insurance company use. Once it had defined the pivot, it advanced two internal and three external candidates to the final stage. The six committee members then set aside a weekend for the sole purpose of doing interviews. They broke into two teams, and each team interviewed the candidates one at a time for about an hour and a half apiece.

The team members talked after each interview, and toward the end of the weekend, the two teams compared their opinions. Each team had drilled into a different line of questioning, but remarkably they ended up with similar views. The directors thought one outside candidate had imaginative ideas for taking the company into new areas, but they weren't sure he could execute. Another, they concluded, was essentially used to building through acquisitions and had no organic growth experience.

Every CEO has an open flank. Often the gap can be plugged by a coach or COO.

The more the search committee members mulled over the candidates, the less sure they were that any of them could make the firm successful. They had been searching for a leader who would move the business into adjacent market segments, but the interview process made them see that there was room to grow within the industry. By the end of the weekend, the committee had rejected all five candidates, even the internal ones some members had initially supported, and redefined the pivot. The firm's headhunter went back to work and recommended two more outside candidates. The committee repeated the small-group interview process, and a new top contender emerged. After the board approved his hiring, the new CEO performed very well.

Ultimately, every board member has to be comfortable with a CEO appointment. Seidenberg says, "I always thought it was important to go around the table at the board meeting and ask every director to weigh in on the choice. The conversation and the issues people raise are always illuminating, both positive and negative. Even the most experienced board members benefit from that conversation."

Reference checking is important too, and great directors do their own. Headhunters can provide an enormous amount of useful background data, but people tell me they will be more candid with a director because they are concerned that the headhunter may keep their comments on file for future use. Direct conversations with people who know a candidate well also give a feel for the strength of their convictions.

Jack Krol, the former CEO of DuPont, who has helped hire more than a dozen CEOs, likes going to people who have managed candidates and asking what results those candidates produced and how they developed other people. Board members who are superficial and overly impressed by things like great communication skills, quickness, and "presence" won't get much out of the conversations, but discriminating directors ask questions that get past the generalities to what candidates actually did and under what conditions. People don't hesitate to discuss the positives, so you can learn a lot about where a person's greatest talent lies. That's the best way to know if a prospect matches the pivot.

Planning for Imperfection

Every CEO has an open flank. The typical vetting process will bring candidates' quirks and flaws to the surface, but wise selectors accept imperfection when they make their decision. Trade-offs are inevitable. For example, many CEOs who come from strategy, planning, or finance backgrounds are weak on people skills or operating skills. Meanwhile, leaders who are strong in digital technology may be weak on finance.

When the directors of one of the world's largest technology companies were seeking a new CEO, they winnowed a field of 20 candidates down to two strong ones: an insider who understood technology and had successfully run a P&L center, and a proven CEO with stellar performance at two nontech companies. Two questions loomed: If they chose the CEO, would he have the expertise and intuition to make fate-changing technology decisions? If they chose the insider, who was untested as a chief executive, would he be able to expand into the broader role? The board members bet that the tech-savvy candidate would grow into the job, and so far their choice is proving to be right.

One board was convinced it had the right next CEO, but the directors also knew he was likely to overpay for acquisitions. They decided they could live with that. Later, when as CEO he proposed a significant acquisition, one of the directors persuaded him to pass on the deal unless the price was cut dramatically. Another board felt that its top choice for CEO was probably not tough enough, so the directors might have to push him occasionally. These boards focused squarely on the pivot, and their selections turned out to be good ones.

Sometimes the gaps can be easily filled. I've known directors to suggest plugging them with a coach or by hiring a chief operating officer or an expert in government relations. Venture capitalists like Andreessen Horowitz are famous for supplementing the skills of their entrepreneurial CEOs by connecting them with people who can help with organizational design or the business model. The VCs do whatever they can to make the CEO successful.

At Delphi in 2009, filling the gap saved the CEO and arguably the company. A new group of investors had stepped in as the firm worked its way out of bankruptcy, and the board had just been reconstituted to include independent directors and representatives from hedge funds. Krol recalls that immediately after he joined as chairman, the hedge funds told him that he would have to fire the CEO, who, they argued, was not communicating well with Wall Street.

Krol believed that the decision to choose a CEO should begin with the dominant needs of the company. Relations with the investment community were important, but so was internal transformation. The pivot, in Krol's view, was operational excellence, a focus on technology, the ability to work with OEMs as Delphi expanded its customer base, and the ability to mobilize the workforce.

The board members ultimately came together and agreed on the pivot—and that the incumbent CEO had the necessary skills in spades. What about the gap? They addressed it by hiring a strong CFO, and the combination worked beautifully. The CEO's performance until his retirement, in 2015, was nothing short of outstanding. The oncestruggling company is today one of the world's largest suppliers of automotive technology to a full range of large OEMs. It also boasts a world-class cost base and outstanding financial performance. The board's move to fill the gap was spot-on.

Selecting the Search Leaders

Choosing a CEO is the responsibility of the full board, but picking the directors who will lead the process is critical. If the wrong people take charge, you'll run into difficulties. Steer toward those who have earned their colleagues' trust and respect. More often than not, they are committee or board chairs or lead directors already. Frequently, they're former CEOs with proven business acumen and very strong values. Their leadership of the search emerges naturally, and their colleagues should welcome it.

Other board members add objectivity through their questions and comments, which any good search leader will welcome. The current CEO also has a role to play in building a cadre of executives the board might choose from and helping the directors learn more about them and the company.

No CEO selection is risk-free, and the results take time to see, but by focusing on the pivot, not playing favorites, and going deep in their understanding of candidates' strengths while also allowing for their imperfections, those driving the decision can avoid common pitfalls and improve the chances of making a fantastic choice.

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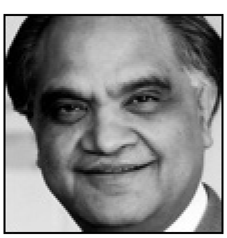

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Krishan Sharma 3 years ago

A good recruitment is the one that defines competencies not only in hard knowledge, skill, or achievement but also in attitude, behaviour, personality, motivation and cognitive abilities. If "the Pivot" is 2-3 things then we don't need elaborate process. Fit is not the last or almost last step as this article predicts but almost first step. This article makes CEO selection more of an art than science as if few are blessed to do a good job at it. I expected something more concrete then sharing first and second hand experiences.

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