

GOVERNANCE CHALLENGES 2019

CEO Succession Planning

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The CEO as ‘Culture Champion’

By David H. Jackson, PhD, Partner, Mercer

Overseeing CEO succession is one of the central strategic and fiduciary roles of the board of directors. How the role of the CEO plays as the “Chief Culture Officer” of the organization must be a critical consideration for the board as they undertake CEO succession and transition planning activities.

The CEO influences culture to such a degree that she or he may be thought of as the key factor that determines the culture of a corporation. In a workforce context, culture is about behaviors that deliver business outcomes and how operational drivers are leveraged to reinforce those behaviors across the workforce. (See Sidebar: *Organizational Culture Defined*)

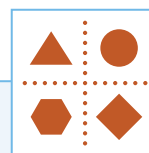
As the ultimate “culture champion,” the CEO drives the employer brand so that her or his organization prevails in the talent wars, and, over time, builds a workforce and working environment in which people are not only engaged but thriving, both today and in the future.

With guidance and accountability by the board, the CEO is the ultimate owner of culture alignment, and it is therefore essential that cultural factors are considered in CEO succession and transition. As noted in a report by Marsh & McLennan,¹ the board’s main instrument by which they can influence culture is through the selection of the CEO, and in turn, the team the CEO develops.

Indeed, as recommended by a recent NACD Blue Ribbon Commission, “directors should make culture an explicit criterion in the selection and evaluation of the CEO and set the expectation that the CEO and senior leaders do the same in their identification and succession planning activities.”²

CULTURE IS CRITICAL TO ORGANIZATIONAL SUCCESS AND A RISK FACTOR IN STRATEGY EXECUTION

An organization’s culture is recognized as vital for success and differentiation and can be viewed as the “rocket fuel” for delivering value to stakeholders.³ Successful businesses show time and again that possessing the right culture that enables employees to thrive can prove to be a source of competitive advantage. One study found that companies with



ORGANIZATIONAL CULTURE DEFINED

Organizational culture can be defined as the organization’s shared and experienced values, beliefs, and behaviors. Pragmatically, it can be understood as the organization’s operating environment. It is what people say and what people do, day-in, day-out, and it is revealed in individual actions that deliver business outcomes, and also in an organization’s norms, working language, systems, and symbols. From a business context, culture should align with the strategy of the organization as well as with market and regulatory factors. From an organizational context, culture is reflected in policy and procedures, and every level of the governance structure should buy into and live the culture. From a people context, the culture enables people to do their jobs, supporting talent acquisition and team effectiveness.

¹ WomenCorporateDirectors and Marsh & McLennan Companies, *Identifying and Responding to a Dysfunctional Culture – Key Actions for Boards*, 2019.

² National Association of Corporate Directors, *Report of the NACD Blue Ribbon Commission on Culture as a Corporate Asset* (Washington, DC: NACD, 2017), p. 20.

³ *Ibid.*, p. 7.

practices that established them as “talent management maturity leaders” outscored peer companies on 18 different performance measures, and in some cases by triple-digit percentage margins. Specifically, they showed 54 percent greater net profit margin and 18 percent better earnings before interest, taxes, depreciation and amortization (EBITDA).⁴

For example, consider the criticality of culture alignment to the success of merger and acquisition (M&A) transactions, which so often represent the biggest capital and branding bets a CEO undertakes. Recent Mercer research found that 43 percent of M&A transactions worldwide experienced serious cultural misalignment, causing deals to be delayed or terminated, or negatively affecting the purchase price.⁵ In the same study, culture issues were cited as the reason 67 percent of M&A transactions experienced delayed synergy realization. Leaders also noted that 30 percent of deals fail to ever achieve financial targets due to cultural misalignment and subsequent problems, such as productivity loss, the flight of key talent, and customer disruption.

WHY IS CULTURE ON THE BOARD AGENDA?

Boards of directors have a responsibility to bring rigor to cultural oversight. It is generally recognized that the board is responsible, alongside management, for setting the “tone at the top” and overseeing management’s strategy to promote a culture that aligns with the organization’s overall strategy. Indeed, the 2018 UK Corporate Governance Code puts a renewed emphasis on calling on boards to assess and monitor culture.⁶

There is also a rising board focus on culture and how the organization operates and achieves its goals. Three trends are driving this:

1. Increased focus on environmental, social, and governance factors (ESG) by stakeholders and investors that includes an emphasis on understanding how organizations treat their employees. Investors are also paying greater

attention to culture-related performance metrics.

2. Acceleration of social activism (e.g., the #MeToo movement) has pushed cultural issues to the forefront of directors’ minds and has reinforced to board members that they can no longer afford a reactive approach to monitoring culture.

3. The amplifying effects of social media and websites that include company reviews by employees (such as Vault and Glassdoor), or customer review sites (such as Yelp), have made organizational cultures increasingly transparent to outsiders. The speed with which information spreads, enabled by social media technologies, has changed the time line of traditional corporate communication processes.

THE CEO AS ‘CULTURE CHAMPION’

Despite the important role of organizational culture and of the CEO as the “Chief Culture Officer,” research suggests that in many instances cultural elements are not formally or clearly embedded in the CEO succession and transition process. For example, survey data suggest that over the past 12 months, nearly 40 percent of boards have formally evaluated the CEO as a leader of organizational culture but just 22 percent have assessed executive candidates for cultural/values fit. However, while assessment for cultural fit is important when reviewing internal and external CEO candidates, according to NACD only 13 percent of boards have used an assessment survey to review the candidates’ “fit as part of their succession planning.”⁷

Poorly managed CEO succession and transition plans pose a serious threat to business performance and, ultimately, to shareholder value.⁸ When a CEO transition goes awry, the collateral damage can be enormous—creating a leadership vacuum, the defection of quality talent, increased internal and external uncertainty, interruptions in normal decision making and business processes, and the loss of shareholder and stakeholder confidence.

⁴ The Hackett Group, Talent Management Performance Study, 2009.

⁵ Mercer, *Mitigating Culture Risk to Drive Deal Value*, 2018.

⁶ Jessica Fino, “Business world reacts to new Corporate Governance Code,” *Economia*, July 16, 2018.

⁷ National Association of Corporate Directors, *2018–2019 NACD Public Company Governance Survey* (Arlington, VA: NACD, 2018), p. 70.

⁸ Mercer, *CEO Succession Planning That Works*, 2012.

GETTING STARTED

How should the board approach the all-important role of CEO succession and transition and ensure that critical considerations about culture are part of the process? Below are a series of specific concrete steps directors can take. (See Exhibit 1.)

1. Determine the desired culture that will catalyze business results as defined by the business strategy, and ensure effective competition for talent recruitment and retention.
 - The board—via the executive, nominating and governance, or compensation/human resources (HR) committee—works with the CEO and the chief human resource officer (CHRO) to select a cultural definition and assessment tool.
 - The kickoff should start with a workshop with the board and senior management, often externally facilitated by culture/organizational design experts, to define the desired culture given the business strategy, evolving business

model, and workforce and leadership talent requirements.

- The compensation/HR committee members, along with the CHRO, compare the desired culture to established skill and competency profiles for the CEO and his/her executive leadership team to ensure the two frameworks meaningfully sync up (i.e., that expected CEO behaviors and areas of acumen will support the delivery of the desired culture). For example, if collaboration is a key characteristic of the desired culture, then the CEO's leadership profile should explicitly include collaboration as a behavioral expectation, as a criterion for CEO selection, and as part of the ongoing annual board evaluation of the CEO.
2. Assess the incumbent's fit with the desired culture.
 - Identify the specific behaviors explicitly in sync with driving the desired culture. Then, the compensation/HR committee should

EXHIBIT 1

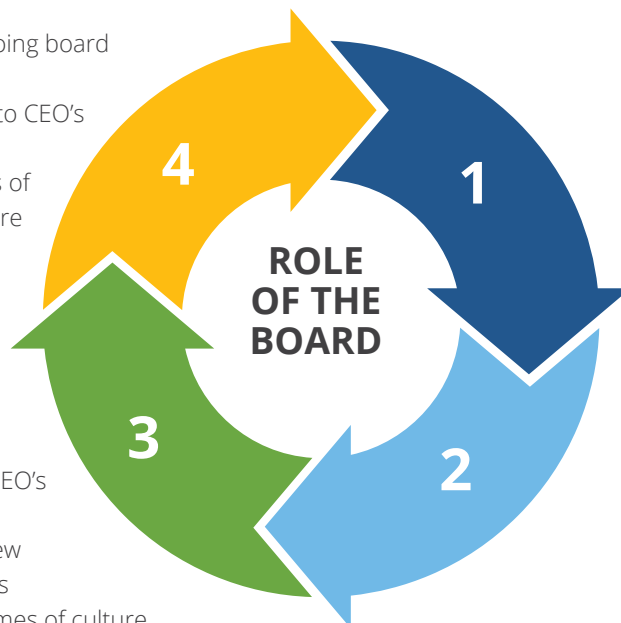
Key Steps In Incorporating Culture Into CEO Succession Planning

TRACK & SUPPORT CEO WITH CULTURE CHAMPIONSHIP

- Track and discuss as an ongoing board agenda item
- Embed culture leadership into CEO's annual evaluation
- CEO and CHRO share results of employee engagement/culture surveys with board

APPLY CULTURE CRITERIA TO SUCCESSION PLANNING

- Share statement of desired culture with candidates for CEO's role and search firm
- Use behavioral event interview methodology with candidates
- Incorporate expected outcomes of culture championship into annual goals, and measure and reward accordingly



Source: Mercer

DETERMINE DESIRED CULTURE

- Define culture
- Select assessment tool
- Compare CEO and executive leadership against competency profile aligned with desired culture

ASSESS INCUMBENT'S FIT

- Identify behaviors required to drive desired culture and communicate expectations to CEO
- Annually evaluate CEO with 360-assessment and interviews with senior management and the board
- Conduct periodic workforce surveys

communicate the board's expectations to the CEO as the foundation for subsequent performance evaluations. The board should emphasize the critical importance of the CEO acting as a driver and champion of the desired culture.

- Annual evaluations of the CEO will reveal the success of the CEO as culture leader and champion, and this should be part of her/his annual feedback. This is most effectively done via an online 360-degree assessment of the CEO's performance that includes the following:
 - Views of directors and members of management. The recommended, empirical, candid mechanism for gathering feedback is the 360-degree review. Interviews with directors and senior management, informed by the 360 findings, will yield actionable insights, and culture should be explicitly referenced in the interviews.
 - Views of the workforce. This can be done with a culture or employee-engagement survey that includes questions about the degree to which the desired culture is manifested in their day-to-day experience as employees.
 - Feedback on the CEO's performance related to supporting and championing the desired culture should be shared in the review process and should influence rewards.
3. Apply the definition of culture, assessment discipline, and associated tools when planning for and executing a CEO succession.
- Document a statement of the desired culture that can be shared with internal and external CEO candidates, and with executive search firms. Ensure that the statement, along with the profile of prospective CEO behaviors that the board believes will drive and sustain the desired culture, is used throughout the succession process, including performance assessment and leadership-development discussions by the board about in-house candidates (facilitated by the CHRO and/or external experts as needed).
 - Use behavioral event interviewing (BEI) methodology with internal and external candidates to ensure that conversations are concrete and specific.⁹
 - Incorporate the definition and expected outcomes of effective cultural championship into the annual goals for the incoming CEO, to ensure that cultural considerations are reflected in performance assessment, measurement, and rewards as described in #2 on the previous page.
4. Support the new CEO as he or she carries out the critical responsibility of culture championship.
- Make culture—including how to steward, track and demonstrate it—an ongoing agenda item in board meetings. Engage the CEO and CHRO in these discussions.
 - Weave measurement of cultural championship, using the CEO leadership profile, into the annual CEO evaluation and make it a part of compensation discussions and decisions. If the board believes that the CEO's leadership style is getting in the way of his or her ability to deliver the desired culture, the board should consider approaches such as retaining an executive coach for development purposes.
 - Request regular reports from the CEO and CHRO on the results of employee engagement/culture surveys.

The job of CEO has always been challenging, and adding a cultural dimension to the CEO's responsibilities could be seen as too subjective, too hard to measure, or too difficult to incorporate into succession-planning processes. But society and organizations today are so dynamic, fast-changing, and stakeholder-driven that a higher degree of cultural rigor is now required for CEOs and boards alike—and a CEO with the right cultural fit can make a transformative difference to an organization's performance over time. When boards ensure their C-suite, leadership bench, and CEO transitions consistently support the organization's desired culture, they will help energize the entire workforce to deliver business results both today and in the future.

⁹ See Libby Anderson's article, "Using Behavioral Interviewing Techniques to Select the Right Employees," July 20, 2008, on the Society for Human Resource Management's website.



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