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# 5 Tips for a Successful CEO Succession

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CEO succession is a fact of corporate life. In a 2015 study, the Corporate Governance Research Initiative (CGRI) at the Stanford Graduate School of Business found that global CEO turnover ranged from 9% to 14% per year. But even though all CEOs eventually leave office, few organizations are well prepared to replace them. Here are five tips for a successful transition.

**1. Have a plan.** According to the *Harvard Business Review* (HBR), a 2016 study of the 2,500 largest public companies shows that public companies that "scramble" to replace a departing CEO "forgo an average of $1.8 billion in shareholder value." Another study found that the longer it takes a company to name a successor, the worse its subsequent performance in comparison to its peers.

Yet despite the inevitability of CEO succession and the high cost of failing to plan for it, most organizations are surprisingly ill prepared. The CGRI's survey data reveals that only 51% of corporate boards could name a permanent successor for their CEOs if required. And 39% have *no* viable internal candidates (in part because boards generally have insufficient knowledge about internal candidates). Although a higher percentage of companies (70%) have identified emergency successor candidates, 68% say these individuals aren't candidates for the permanent CEO position.

To be better prepared for CEO succession, the CGRI recommends that corporations treat succession planning as a risk management element. That means identifying viable candidates — both internal and external — well in advance of a CEO transition. This can take years, rather than months or weeks.

**2. Look at insiders and outsiders.** In recent years, there's been a trend toward recruiting external CEOs. But grooming a successor that's risen through the company's ranks has distinct advantages. Insiders know the company's business better than anyone, tend to be compatible with the corporate culture and are well known by current management, staff and the board. Plus, studies show that insiders generally deliver better market-adjusted shareholder returns than externally recruited CEOs. Some commentators believe that these studies are misleading, however, arguing that companies are more likely to hire outsiders when they're struggling financially, placing outsider CEOs at a disadvantage after they take the helm.

Another advantage of naming insider CEOs is that they're typically paid less than their external counterparts. The HBR reports that the median pay of CEOs hired from outside the company is $3.2 million more than that of insiders. This may be because companies must buy out external CEOs' contracts or pay a premium to attract them (particularly if the company is struggling financially).

Despite the advantages of hiring insiders, companies shouldn't rule out external candidates. If there are no qualified internal candidates or if an external candidate would be better suited to lead the company, resist the temptation to hire from within simply because it's easier and cheaper.

**3. Create a strong leadership development program.** It's critical to integrate a CEO succession plan with a robust leadership development program. This will help the company identify the best internal candidates as early as possible, bring them to the attention of the board and provide the training they need to assume a leadership role in the future.

**4. Get the board involved early.** Outgoing CEOs play a critical role in succession planning. They can identify and develop talent, mentor internal candidates and provide insight into the skills and qualities needed in a successful CEO. One catch: Outgoing CEOs, especially at companies that are performing well, tend to target candidates that have attributes similar to their own. The board should drive the process to ensure that the successor is the right person to implement the company's strategic vision going forward.

**5. Link succession planning with compensation.** Compensation can be a powerful tool for succession planning. Equity-based incentives that vest over time can help discourage internal candidates from jumping ship. And some companies tie a portion of their CEOs' or other senior executives' bonuses or other incentives to their successful development and implementation of a CEO succession plan.

**Start now**

Regardless of how you approach CEO succession planning, the time to start is now. The need to find a new leader can arise suddenly for a variety of reasons. The current CEO may die, become disabled, or decide to step down. Changes in technology or the industry may require a CEO with a different skill set. External pressures from shareholders or the public may demand a change in leadership. The sooner you have a plan in place, the smoother the transition will be.