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On-Boarding A New Outside CEO

Finding a good CEO is just the first step.

by Randall S. Cheloha, Ph.D. and Jacob Kumaresan, M.D.

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The selection of a new chief executive, the keystone of company management, is typically the only hiring decision made directly by a board. If the new CEO comes from outside the company, a smart “on-boarding” process is needed for success. However, this can be easily ignored. Selecting a good CEO is only the first step in the board’s task of assuring that the new CEO succeeds.

While all new CEOs face daunting challenges, CEOs coming into an organization from the outside must immediately navigate some unique hurdles. As an unknown quantity, the new outside CEO must quickly establish credibility with a wide range of constituencies and stakeholders. All of these are watching their every move to determine how the new CEO fits into the company, and he or she can adapt to the culture.

Of course, published research on CEOs coming into a company from the outside is not exactly encouraging, suggesting that roughly two thirds will fail. Usually, the company has a backlog of crucial tasks to accomplish. Depending on the length of the search, almost everyone (including the entire board) wants to see the new CEO dig in, get things done, and succeed.

Frequently in the business sections of major newspapers and other media outlets we read about the failure of well-qualified, well-vetted outsider CEOs to “fit in.” This has a traumatic effect on the company, its culture, and its market value, forcing the board to once again post a “help wanted” sign on the door.

These prominent failures create huge ripple effects, including the loss of millions, even billions of market cap. Examples include Mark Hurd’s departure at Hewlett-Packard, on the heels of another CEO pushed out, Carly Fiorina. In both cases HP suffered major organizational disruptions. While impossible to calculate precisely, the costs both hard and soft are significant when any CEO fails, particularly an

“outsider” CEO. These include:

- Loss of market cap from uncertain financial markets.
- Paying severance to the departing CEO (generally two to three times annual compensation).
- Morale and productivity issues throughout the company.
- Loss of credibility for the board.
- Need to increase CEO compensation to attract an outsider (which drives pay increases for other senior executives to maintain parity).
- Uncertain key executives may need “retention” contracts to insure they stay for the transition.
- Loss of key internal executives, who are at risk depending on who is the next CEO.
- Hiring costs for the next CEO (such as moving costs, perks, bonus guarantees, etc.) to make him/her “whole” for leaving their previous position.
- One third of the new hire’s annual compensation paid to the search firm.

While the costs of a CEO failure are huge, less than 50 percent of companies have a viable CEO succession plan. More needs to be done to ensure the success of new CEOs.

This is combined with the loss of time, energy, and dollars already invested by the company in their succession planning systems. However, research from Heidrick & Struggles and Korn Ferry both conclude that less than 50 percent of corporations have prepared a viable CEO succession plan. This suggests it is likely that companies will need to recruit more outsiders for CEO, plus they are increasing their risk profile in retaining this new CEO. This leads to the

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conclusion that more needs to be done to insure the success of outsider CEOs.

Executive compensation consultants like Mercer and Hewitt Associates point out that recruiting an outside CEO is more expensive than choosing an internal successor, as the company is forced to go to the market for the needed talent. Part of the increased compensation costs are driven by the risk the incoming CEO faces if the organization rejects him/her. They have likely lost their one opportunity to be a CEO, at least in a like-sized company. Worse, if the failure plays out over years, the executive may miss the age “window” for CEO recruitment. There is also a need to re-calibrate senior executive compensation to align it with the new CEO.

Given the high risk (and costs) of recruiting an outside CEO, you would expect boards to take special care to ensure their success. Yet many boards view on-boarding as excessive, or showing lack of confidence.

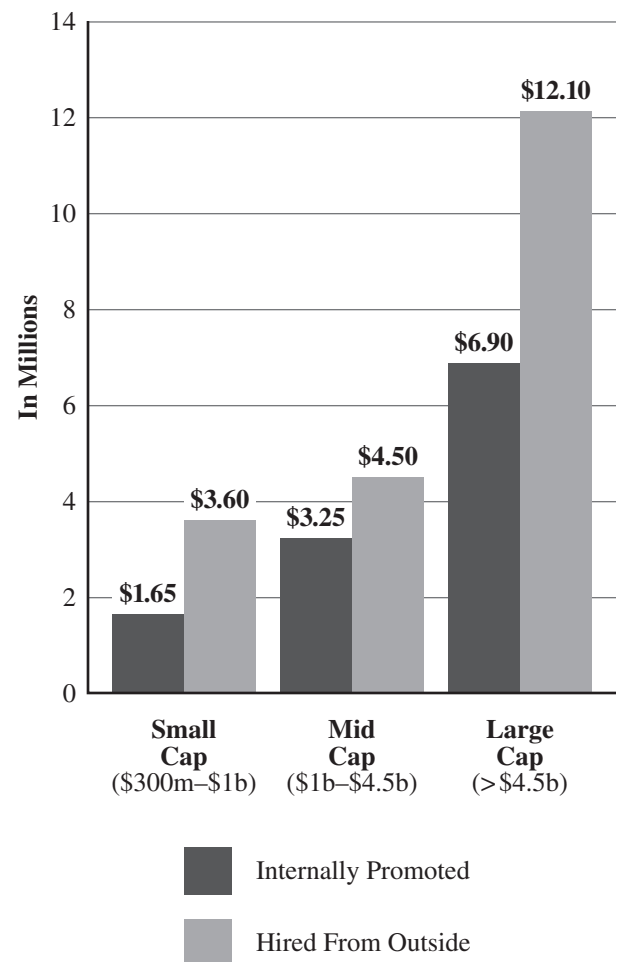
The literature on outsider success/retention at senior levels, specifically CEO and COO, is not re-assuring. Approximately two thirds (66 percent) of recruited outsiders leave within five years, either on their own initiative or with board “assistance.”

Given the high risk level involved in recruiting and retaining an outside CEO (not to mention the expense), you would expect the board of directors to take special care to insure their new CEO’s success, including implementing an on-boarding process. However, many boards fail to consider such a process, viewing it as excessive, or showing a lack of confidence. Based on our experiences (with both positive and negative outcomes), we offer some recommendations to boards for ensuring their new outsider CEO succeeds, and that their considerable investment pays off.

Boards generally go to the outside for a CEO or COO for some combination of the following three reasons:

- They are unhappy with the company’s performance and direction.

The High Price Of Failure Median Total CEO Compensation



Source: Equilar (compensation consultants) in a study of 1,300 companies with CEO hires from April 30, 2007 to March 31, 2008.

- Public relations/media issues require an outsider to restore confidence with major shareholders, the markets, and the media.
- Lack of a viable inside candidate.

We have broad, combined experience in implementing on-boarding processes for new outside CEOs and other executives. Following is a case history, with recommendations on how boards can successfully on-board a new CEO (all identities in this article have been changed to protect confidentiality).

John Franholtz was chosen from the outside as the new CEO for Grammer Health Care System (GHCS),

a not-for-profit regional health care partnership. This regional health care provider served the tri-state mid-Atlantic region, and consisted of eight suburban hospitals, satellite outpatient clinics, and multiple outsourced service providers including laboratories.

The governance of the joint venture directly mirrored this structure, with a board of six directors from the doctor group and six from hospital administration.

The newly recruited outside CEO left a large, for-profit system where he had profit and loss responsibility for multiple hospitals. The board saw a clear fit since he had considerable mergers and acquisitions experience. The board was focused on an acquisition strategy which called for expansion up and down the east coast and into the mid-west.

The outgoing CEO had “grown up” within his previous organization, where he led its expansion from a single hospital to a chain of eight regional hospitals. However, in the board’s view, he lacked the skills and experience to take the organization to the next level.

We recommend that boards implement several on-boarding tasks to ensure success and smooth the way for the new outside CEO.

□ *Task 1: Build strong relationships between the incoming outsider CEO and board members.*

Dr. Franholtz naturally expected the full support and confidence of the board. During the search process they had carefully reviewed several internal candidates and compared them directly to outside candidates against pre-defined success criteria. They finally reached the conclusion that no insiders were capable of being CEO. Despite considerable resistance from several passed over executives on the current CEO’s team, the board was 70/30 in favor of bringing in an outsider.

The CEO candidates were wined and dined, and the red carpet rolled out. They were invited to hospital and corporate social occasions, and met several key large community donors (including the chairman of the latest fund drive). The board worked very deliberately to present a desirable CEO position to attract

the strongest talent with upside potential.

The board thus made a major investment in search, travel, interviewing (plus the need to offer an enhanced pay package, an increase of 40 percent over the previous CEO’s). You would therefore expect the board to be 100 percent behind their new CEO, and make every effort to ensure that he got off to a good start.

While the directors were 100 percent behind the new CEO, at least conceptually, they did not consider any formal integration plan. The board needed to address several delicate internal scenarios to retain several senior executives who had been passed over.

In an attempt to soothe the hurt feelings and sense of betrayal for the passed over internal executives, they upgraded titles and gave pay increases. The board’s hope was that these measures (along with letting the new CEO know about the need to “bring them on board”) would give the CEO a motivated management team to work with as he began his new role.

Many boards adopt a “hands off” policy with the new CEO. We recommend the board stay close to their new CEO, and continue building their relationship.

The board also adopted a “hands off” policy towards the new CEO. They reasoned that they were hiring the best, and to ensure his success they should stay out of the way and not interfere. While well intentioned, this actually worked to their disadvantage and fueled a widening communication gap.

Instead, we would have recommended the board stay close—very close—to their new CEO, and continue building their relationship. For example, they could increase the frequency of board meetings (they currently held quarterly meetings) along with including him in appropriate board functions. A lead director could have consulted with the CEO about board issues, asking his advice. At a minimum, board members could share responsibility for having lunch with the new CEO to assure communication channels were open and information was flowing frequently.

The board could also sponsor a formal integration

and relationship building plan for the new CEO. This could include appointing a director to monitor how the transition was proceeding, and keeping a finger on the pulse of the company.

□ *Task 2: Anticipate and deal realistically with resentful “passed over” internal candidates.*

Rather than “hitting the ground running” with a team of direct reports (who had enthusiastically affirmed their commitment), the new CEO found himself enmeshed in complex, intricate political gamesmanship in dealing with the COO and CFO. These two had joined forces behind the scenes to band against the incoming CEO.

The passed over executives quickly used back channels and started a whisper campaign, calling attention to any of the CEO’s missteps or mistakes, and calling into question his overall capability. In essence, they undermined him.

New CEOs are almost totally dependent on the honesty, candor, and support of the board and their subordinates.

The disgruntled executives also used a classic passive/aggressive approach. They would agree with the CEO on new initiatives, while either covertly talking them down or doing nothing (while continuing to spread negative perceptions). All of this was having the desired effect, with the negatives making their way back to the board through private communication channels that flowed around the CEO.

New CEOs are almost totally dependent on the honesty, candor, and support of the board and their subordinates, particularly when they are getting to know the organization. They know the history of the company and its evolution. Directors are in a unique position to advise the CEO about where the land mines are buried, and how to unify the internal structure.

Unfortunately, human nature almost guarantees some level of discontent, sometimes growing so severe that passed over subordinates are actively looking for new positions. From a practical perspective, the remaining insiders also know their job is

not secure and is dependent on their demonstrating their capabilities and utility to the new CEO. The new CEO, in turn, may wish to bring in trusted direct reports from his former company.

The wise and prepared board accepts these realities. They will have begun contingency planning to ensure that, if a significant insider leaves, they have a replacement ready or being groomed to take his or her place.

This board would have been better advised to let the new CEO directly address the disappointment of the passed over insiders, and calibrate the likelihood of their staying or leaving. The board also chose to listen to the insiders, rather than consider the source. They could have gone directly to the CEO with the negative information they were hearing in order to keep reporting lines clear and demonstrate support. By allowing the internal executives to go around the CEO, they tacitly supported his potential failure.

The situation spiraled from bad to worse. The board was becoming disenchanted with the new CEO. They were hearing about organizational inertia, plummeting morale, and a “micro-manager” CEO (who had little choice since his direct reports were passively resisting new initiatives).

The new CEO sought counsel from the board, but was often ignored. Essentially, he was cut out of the information loop.

□ *Task 3: Bring in a coach to help the new CEO.*

A major disconnect was occurring between what the board expected with what they were hearing. Information vacuums produce anxiety, paranoia and fear on all sides. The new CEO logically tried to open up communication and build his relationship with directors through multiple channels. This included formal and informal reports to the board, making frequent “information” calls to board members to brief them on events, and seeking impromptu meetings with board members (many of which were ignored). Essentially, the new CEO was cut out of the information loop.

At this point, consistent with many on-boarding

processes, we would recommend the board bring in an outside “coach” to help the CEO and also provide the board an unfiltered view on the inner workings of the organization. The board did engage an outside resource to coach the CEO at the one year point. They were concerned that the time and money spent in recruiting and hiring a new CEO, along with the perceived inadequacies of the new CEO, were heading towards failure.

The outside coach’s role was to work with the CEO to get him back on track. Because the situation had reached a crisis point, the board kept the coach at arm’s length and had him communicate through their attorney. Legally, this insulated the board from the CEO if they were forced to terminate him. However, it made matters worse because the communication gap between the CEO and the board deepened in spite of the coach’s interventions.

Not only was the CEO unaware of the board’s increasing negative perceptions, the coach was operating “blind” of their perceptions and expectations. With only four formal board meetings a year, there were few opportunities to clear up confusion and clarify what the board was hearing through back-channels.

The external consultant began to piece together an accurate view of the internal executive undermining and lack of support through a series of interviews across the organization. The CEO and the coach realized that the team was not working.

The CEO eased out most of his direct reports, bringing in new talent to stabilize the situation. The board proved receptive to the CEO breaking through the inertia. Board expectations were being met and the back channel communications ceased. The CEO was able to mend some strained relationships with key board members.

The number of board meetings also increased from four to six a year, which prompted more back and forth communication. Finally, with the CEO freed from day to day management (the “hands on” style which had become a source of board and direct report frustration), he was able to invest more of his time in community outreach for funding and building their donor base.

Within nine months, the majority of his direct reports had been replaced. There was a new COO, CFO, marketing VP, and director of communications. The team began to pull together and within an additional six months the system made its first acquisition, a large urban hospital which they successfully integrated. The system has continued to grow, the management team has remained intact, and the CEO is now at the four-year point in his tenure. He is now living up to the capabilities the board thought they had hired.

A formal on-boarding plan gives the board a firmer grasp on internal dynamics and provides direct support to the new CEO.

The board could have prevented many miscommunications by sponsoring an on-boarding process. A formal on-boarding plan would have allowed them to have a much firmer grasp of internal dynamics, and provide direct support to the CEO.

What lessons can this on-boarding example offer for your board and a new CEO?

Either the board or a consultant/coach can develop a formal on-boarding process for the CEO, including a month-by-month schedule of activities for the new chief. The on-boarding process should include success “markers” that range from alliances formed, to board directors met for advice on retaining insiders, to falling back on a contingency plan. Board members could introduce the new CEO to important stakeholders within and outside the company, and choose important meetings to attend to support getting to know the new CEO. Ideally, some of these meetings could also be attended by a board member.

Work with the CEO to directly address the passed over insider concerns—but let the CEO manage this process. Allow the new CEO the opportunity to determine whether or not he can work with the existing senior management team, or if alternatives need to be considered.

Appoint an outside coach to help the CEO, providing support, guidance and counsel from an

unbiased perspective. Not only can the coach keep the CEO informed on perceptions of culture, major players, and important events, but can provide the same perspective to board members. While not a perfect solution, this is much preferred to relying on rumors and end-run communications from potentially disenchanted or resentful insiders.

□ *Encourage the CEO to build strategic alliances.* As part of the job evaluation, the board should monitor the CEO's continued building of outside alliances with board members, customers, service providers, service recipients, and the community at large. These relationships provide additional insight into the CEO's style, how he handles conflict and controversy, and provide the board with insights to make mid-course adjustments to their new relationship with the CEO.

□ Finally, the board could rely on some traditional tools including HR surveys of attitudes and morale. Share these at upcoming board meetings, and have directors attend a senior "team building" offsite so they have a sense of how inside relationships are developing.

The CEO's success depends on positive and aligned relationships with his/her team of direct reports and the board of directors. Despite the popular press heralding the capabilities and strategic brilliance of CEOs, realistically the CEO is dependent on the board above him and the executives below him to get the job done. CEOs can add considerable value through strong leadership and leveraging the power vested in them. However, they simply cannot do it alone. ■

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