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CEO Succession Planning Through Disruption

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Boards in industries facing disruption should keep a close eye on CEO performance metrics and be willing to pivot when necessary — on performance metrics, strategy and CEO succession, experts say.

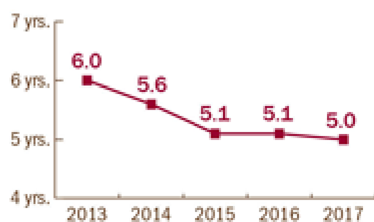
What is needed today and in the future is “going to need to be anticipated in a more planful way, or it can catch boards short,” says **Jane Stevenson**, global leader for CEO succession and vice chairman for boards and CEO services at **Korn Ferry**.

“Really thinking about the kind of leadership that will be important to have and making sure that’s getting developed inside the organization is going to be more important, particularly in the kinds of industries [that are facing disruption],” Stevenson says.

Revlon, Inc. became one of the latest large-cap companies facing industry disruption to shed its CEO when it announced the retirement of **Fabian Garcia** on Jan. 29. Cosmetics giants have been dealing with growing competition from digital start-ups as well as shifting consumer preferences. Revlon’s stock price had dropped by 34% in the 12 months leading up to the announcement.

Similarly, **Avon** announced last week that **Jan Zijderveld** would succeed CEO **Sherri McCoy**, whose employment was terminated in August. Also last week, retailer **Hudson’s Bay Company** named **Helena Foulkes** as CEO, replacing **Gerald Storch**, whose departure was announced in October.

Median CEO Tenure Declines in S&P 500



Source: Equilar

Overall, CEO turnover declined in 2017, according to a new report by **Equilar**. However, the average CEO tenure rate across S&P 500 companies is also falling, according to the study. The data shows that median CEO tenure in this group fell to five years in 2017, down from six years in 2013.

Experts attribute declining large-cap CEO tenure to a number of factors, including a tight CEO job market, investor activism and a large cohort of CEOs' recently reaching retirement age. Additionally, they say, a disproportionate amount of CEO turnover is occurring in industries facing disruption, such as consumer products, retail and energy.

For example, Garcia served as CEO of Revlon for less than two years, while McCoy served at Avon for five. Storch had been CEO of Hudson's Bay for less than three years.

Industries undergoing technological disruption saw a higher rate of disciplinary dismissals of CEOs, according to a recent report by **The Conference Board**. It defines "disciplinary dismissal" as the departure of a CEO younger than 64 that occurs when the company's total shareholder return is in the bottom quartile of all S&P 500 companies. In 2016, 27.8% of consumer-product CEO successions, 50% of wholesale and retail CEO successions and 75% of extraction CEO successions were due to a disciplinary dismissal. By contrast, 12.5% of manufacturing CEO successions were due to disciplinary dismissal.

Performance Metrics

According to **Matteo Tonello**, managing director of corporate leadership at The Conference Board, tougher long-term performance metrics are likely behind many of these departures.

For example, he says, there has been an increasing shift toward evaluating TSR over three- to five-year periods for the purpose of rewarding CEO performance. Additionally, he points out an overall shift toward long-term incentive plans that use a blend of two or three performance metrics in combination with TSR "to incentivize stock appreciation, corporate results, and talent retention," he writes in an e-mail.

In industries undergoing rapid change, long-term performance metrics set three to five years ago can be difficult for CEOs to hit.

"[T]hink of the difficulties reported by many companies in the retail sector to meet earnings targets and the challenges to retain talents that the most traditional of those companies are experiencing as a result of evolving business models," Tonello says.

Sources emphasize that simply making the targets easier for CEOs to meet will not necessarily prevent CEO departures. However, in some cases, new performance targets may be necessary to take the company in a different strategic direction when facing a disruptive environment.

"Management and the board need to become more realistic about the threats to their business, identify them sooner, and become more proactive in responding," says **David Kollat**, chairman and president of **22 Inc.**, a retail and consumer goods consultancy.

Kollat, who is also lead director at **Wolverine World Wide** and chair of the compensation committee at **L Brands**, adds that the board and management must "think about developing a compensation system that requires this proactive stance."

"You have to draw a line in the sand," he says.

Furthermore, Kollat says that disruption in many industries is due to a shortening of product life cycles. Therefore, he says, perhaps boards should develop performance metrics that track product development time lines.

Some companies do this by tying CEO pay to R&D budgets, but that hasn't always proven effective, he says. Instead, perhaps the board could require that the company have a minimum percentage of products in an introductory development stage.

Meanwhile, Stevenson says that by the time the effects of industry disruption are appearing in performance metrics, the company has already likely missed its opportunity to be proactive. Instead, she says, boards should ensure management is focusing on internal talent development in order to meet potential challenges as they arise. After all, she says, it takes five years for companies to develop capabilities in completely new areas; incentivizing management to develop talent can keep it focused on the company's future strategy and the external threats that drive disruption.

"So as boards understand where they think the market is heading … they are then in a position to look at the next couple generations of leaders and to look at [whether] they have the ability to either provide training or experiences for people to build those capabilities, or to import them from the outside and to do it in a way that creates as seamless a transition as possible," she says.

Succession Planning

Kollat warns that determining whether a CEO change is needed is a delicate decision for the board, even when the company is facing challenges.

"On the one hand the company isn't getting good performance, and on the other hand, if you hire a new CEO … there's no assurance the new CEO will do a better job," he says.

"If you're wrong about the person that you chose, you're probably looking at three, four or five years of that continued poor performance. So you're between a rock and a hard place," he says.

Meanwhile, several sources interviewed for this article say higher CEO turnover in disrupted industries shouldn't be viewed as a problem. In many cases, the CEO's departure from disrupted companies is the sign of an engaged board.

"Big institutional investors are interested in ensuring that a company's long-term strategy is aligned with their interests as long-term shareholders. It isn't always about the individual in the C-suite, it's about the board and the overall management team's approach to long-term value creation," says **Chris Wightman**, partner at **CamberView Partners**.

"That's part of the reason we're seeing investors focused in unprecedented ways on who's in the boardroom," he says.

Finally, experts warn that boards in industries that are not currently dealing with a disruptive environment should try to learn from those boards that are. In fact, says Stevenson, that's one of the benefits of a board with a diverse set of industry experiences.

"Using those diversities of vantage points can be really productive and moves boards to what I call the strategic level of capability. [These boards] … are not just reactive and managing the downside of risk, but [they are] boards that are evaluating the potential for opportunity, and therefore, given that opportunity, evaluating risks differently," Stevenson says.

Tonello says The Conference Board expects CEO turnover in energy, retail and consumer goods to die down in the coming years as companies get a handle on where their industry is going. However, others are poised for challenges.

For example, Tonello writes, artificial intelligence is expected to disrupt several other industries, including transportation and health care. Boards of these industries will likely feel pressure to address business model changes in similar ways.

"Never take continued success for granted, and always be ready to anticipate the next trend and find the leader needed for a business to continue to evolve," Tonello writes. "Strategy and CEO succession are inherently intertwined."