How the best boards approach CEO succession planning

And why it’s become more critical than ever

Many boards aren’t fully prepared for CEO departures despite succession planning being one of their primary responsibilities. If we’ve learned anything during the pandemic, it’s that anything can happen. There are important steps directors can take to be better prepared for both planned departures and the unexpected.
Why CEO succession planning can be hard

Planning for who will be the company’s next leader has long been one of a board’s most important responsibilities. Without the right person at the top, even the best companies with the most innovative strategies will struggle. The COVID-19 crisis has accelerated the pace of digital transformation, industry consolidation, and flexible work arrangements. So, boards may need to rethink the skills they look for in a top leader in the post-pandemic environment.

Businesses need strong leadership more than ever. Yet all too often, boards are caught unprepared when they need a change in leadership. Why does this happen? For a start, it can be difficult just to have the conversation. In high-performing companies, directors may be concerned that broaching the topic of succession will cause the current CEO to think they are looking for a replacement. In under-performing companies, directors may want to avoid doing anything to make the CEO worry about job security when they need to focus on driving strategy.

So, why not put off what could be a painful process? Especially when the CEO is performing well, and the conversation doesn’t feel urgent? Because planning for the company’s next leader is in the best interest of the company and its shareholders.

More than half of board members in a recent survey say they need to improve their CEO succession planning. But this is easier said than done. To help directors find a better approach, we’ve identified the leading practices that can help boards better plan for CEO succession.
The changing nature of CEO succession planning

The environment for CEOs is changing. In 2020, 56 S&P 500 CEOs resigned. Of those who quit, 20% did so under pressure, up from 13% the year before. Meanwhile, average CEO tenures continue to fall, making it increasingly likely that directors will oversee more CEO successions during their board service.

As organizations readjusted their business models, supply chains, and ways of working to weather the pandemic, it became more common to look for leaders outside the company. For example, in 2020, 29% of S&P 500 companies that replaced their CEOs hired an outsider, up from 21% in 2019. Going forward, boards may need to place even more emphasis on appointing leaders with M&A transaction and merger integration experience, digital transformation expertise, and greater familiarity with leading flexible workforces.

Reasons for CEO transitions

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Former CEO retired or stepped down</td>
<td>75%</td>
</tr>
<tr>
<td>Former CEO resigned under pressure</td>
<td>20%</td>
</tr>
<tr>
<td>Health reasons</td>
<td>4%</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>2%</td>
</tr>
</tbody>
</table>


CEO successors: internal vs. external candidates

<table>
<thead>
<tr>
<th>Year</th>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>71%</td>
<td>29%</td>
</tr>
<tr>
<td>2019</td>
<td>79%</td>
<td>21%</td>
</tr>
<tr>
<td>2018</td>
<td>73%</td>
<td>27%</td>
</tr>
<tr>
<td>2017</td>
<td>69%</td>
<td>31%</td>
</tr>
<tr>
<td>2016</td>
<td>90%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Seven leading practices in CEO succession planning

While some boards avoid CEO succession planning, others find ways to lay the groundwork for smooth CEO transitions. How do they do this despite the more immediate pressures of overseeing quarterly performance and strategy execution? We’ve identified seven characteristics that may make them successful.

1. They agree on the skills, experience, and personal traits the CEO will need to execute the company’s current and future strategy

A common roadblock to having productive CEO succession discussions is a lack of consensus about how the company’s short- and long-term strategies should affect choosing the company’s next CEO. Finding common ground starts with assessing the factors most likely to impact the business over the next three to five years, such as changing customer demands, climate change, and technological advances.

Once the board agrees on how the company’s strategy should reflect these changes, it can identify the skills and experience the next leader will need to achieve its key objectives. Because market conditions change quickly, the board’s process for identifying key CEO capabilities needs to be dynamic. Without routinely refreshing their thinking on what it takes to lead the company, boards can’t truly know what they need in a CEO.

At the same time, directors need to identify the qualities that would make a leader a good cultural fit. If the culture needs to change, they need to define the type of person who could lead the shift. This process should also include conversations with the current CEO and the senior management team to identify the critical attributes for CEO success both today and in the future.
They know who owns the succession planning process

Overseeing CEO succession planning is widely considered a full board responsibility. But determining who does what within that mandate can be challenging. Most boards designate the nominating and governance or compensation committees to lead these efforts. Some have created a special ad hoc committee for this purpose. No matter the structure, what’s most important is to establish clearly defined roles and responsibilities.

If a board committee oversees CEO succession, it needs to provide the full board with regular updates so all directors understand the process, plan, and pipeline. The sitting CEO’s level of involvement in succession planning will vary. At the very least, their responsibility should include developing internal candidates. The board chair or lead director typically acts as the point of contact for board discussions with the CEO about succession planning.

Who is responsible for CEO succession planning?

<table>
<thead>
<tr>
<th>Industry</th>
<th>Full board</th>
<th>CEO succession planning committee</th>
<th>Compensation committee</th>
<th>Nominating/corporate governance committee</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>49%</td>
<td>20%</td>
<td>16%</td>
<td>13%</td>
<td>2%</td>
</tr>
<tr>
<td>Financial services</td>
<td>42%</td>
<td>12%</td>
<td>13%</td>
<td>17%</td>
<td>15%</td>
</tr>
<tr>
<td>Nonfinancial services</td>
<td>61%</td>
<td>10%</td>
<td>22%</td>
<td>3%</td>
<td>5%</td>
</tr>
</tbody>
</table>

They have a documented plan with a timeline and process for updating it

To keep CEO succession planning a priority, directors need to lay out the goals of the process, the cadence for discussion, the short- and long-term aspects of the plan, and the details of the candidate development program. They should also determine how often CEO succession planning is on the board agenda. And although the current CEO can provide valuable input, the board should regularly discuss CEO succession in executive sessions.

The result of these discussions should be a documented CEO succession plan that describes the responsibilities and expectations of the new CEO. It could also include the skills and experience they will need to drive the company’s long-term strategy and a list of possible candidates.

The plan could also establish a timeline for each step the board will take, from assessing internal candidates and interviewing external candidates, to appointing the new CEO and announcing the board’s choice publicly.

The full board should review the succession plan at least once a year. This allows directors to update the capability requirements for the next CEO as the company’s needs change.

They have a well-defined emergency succession plan

Too many boards have only a vague notion of how they would respond to a sudden CEO departure. Given the abrupt rise in CEOs leaving unexpectedly, companies without an emergency plan jeopardize their financial futures and relationships with stakeholders.

Developing an emergency succession plan requires identifying strong interim candidates who can step in quickly, such as the CFO, COO, or other candidates already being groomed for the position. Having emergency CEO candidates spend time with the board and the current CEO to better understand the business will help smooth the transition. And the board’s discussion should include whether a director could temporarily step into the CEO role while the board searches for a long-term replacement.
PwC perspectives – CEO succession
The perfect opportunity to consider other types of change

**Reduce overboarding:** During a CEO transition, boards should review their company’s policy on the number of outside directorships the CEO can hold while serving as the top executive. Institutional investors, activists, and proxy advisors often consider overboarding, particularly of CEO directors, when making voting recommendations and decisions. During a CEO succession, boards can revisit whether they need different limitations.

**Rethink board leadership structure:** Calls to separate the board chair and CEO roles have become more common. Some shareholders argue that a unified role diminishes the independence of the board. Transitions involving an outgoing CEO who is also the board chair are a good time for directors to assess whether that board leadership structure is still appropriate.

**Increase diversity:** The number of female CEOs in the S&P 500 rose to 34 in 2020—the highest ever. But there have only been 86 female CEOs since 2000 in the S&P 500. When searching for CEO candidates, boards should make a concerted effort to consider CEO candidates that differ in gender, age, race, and ethnicity.
They engage their CEOs in succession planning from day one

Once boards have gone through the hard work of appointing and transitioning a new CEO, few have the appetite to restart the planning process. Many put it off for two to three years after the new CEO is appointed. Nearly one-third of the directors in PwC’s Annual Corporate Directors Survey say the biggest hurdle to getting started earlier is that the current CEO is meeting expectations.

One way to reduce the awkwardness of talking to a CEO about who might replace them is to make it a routine conversation. Discussing successors regularly, no matter who holds the position and how they are performing, will help make the conversation feel less personal.

Boards that make it clear to their CEOs from day one that planning for their succession is a critical part of their job can circumvent much of the anxiety about whether the CEO will feel threatened by the process. Their responsibility, much like the board’s, is to avoid the disruption of a messy CEO transition.

The CEO’s primary role in succession planning is to identify potential successors and make sure those people are getting the proper experience and exposure to assume the position. Accordingly, directors should ask for regular updates from the CEO and chief human resources officer on their progress in identifying and developing internal candidates.

What is the single greatest challenge to more timely and effective CEO succession planning?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Challenge</th>
</tr>
</thead>
<tbody>
<tr>
<td>32%</td>
<td>Current CEO is performing as expected</td>
</tr>
<tr>
<td>17%</td>
<td>No clear internal CEO successor exists</td>
</tr>
<tr>
<td>12%</td>
<td>A clear internal CEO successor exists</td>
</tr>
<tr>
<td>7%</td>
<td>More time-sensitive matters to address</td>
</tr>
<tr>
<td>6%</td>
<td>Discomfort in having the conversation</td>
</tr>
<tr>
<td>6%</td>
<td>Difficulty in agreeing on the most important candidate attributes</td>
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Note: 24% of directors responded ‘None of the above’
They have a strong pipeline program

Directors rank maintaining a strong pipeline of CEO-level talent as their number one challenge in succession planning. And yet a weak pipeline can result in a scramble to fill the role or choosing someone who’s not yet ready for the challenge.

A formal internal candidate development program should provide first-hand experiences in the functions the CEO performs, including reporting to the board. This, in turn, enables the board to get to know candidates and evaluate their performance. Candidates in the pipeline should also gain exposure to various aspects of the business and be given responsibility for major initiatives like guiding the company’s entry into new markets.

It’s also essential for directors to deepen their understanding of the external talent market. For example, confidential external benchmarking to identify outside talent that might be considered for the CEO role can give directors a stronger sense of the strengths and weaknesses of their internal candidates.

When two or more internal candidates are competing for a CEO vacancy, directors need to be mindful of the potential impact on company culture. Candidates may become competitive, and until a final decision, tensions can run high.

Directors also need to anticipate the possibility of executives passed over for the position leaving the company and conduct scenario planning. For example, which candidates do they want to stay after the decision? Depending on the answer, directors can find new roles or opportunities for the executives they are interested in retaining. They will also need to think about who might replace those who leave after making the new CEO appointment.

They understand the importance of good onboarding, championing their chosen candidate and communicating the process to stakeholders

Failing to adequately onboard an incoming CEO, particularly an external candidate, will put them at an immediate disadvantage. The best boards ensure there’s a transition plan that helps the new CEO get up to speed on company goals, strategy, and company culture. Directors also need to invest time in listening to and guiding the new CEO.

To maintain transparency, boards can outline their CEO succession process in the company proxy statement. This could include a description of who’s responsible for leading the process, how they identify and assess CEO candidates, how often the board reviews the succession plan, and how they would respond to an emergency departure.

Finally, directors need to promote the new CEO to lay the groundwork for a successful tenure. The media, employees, and other stakeholders should all hear the message that the board fully supports the new executive.
Eyes on the prize

These turbulent times demand much more from corporate leaders. Done well, CEO succession and transition planning can increase a company’s chances of getting a CEO who can lead the company into a profitable future. If done poorly or neglected, the company’s prospects—and the futures of those who depend upon it—are left to chance. And that’s a chance the best boards aren’t willing to take.

Contacts

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC’s Governance Insights Center.

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