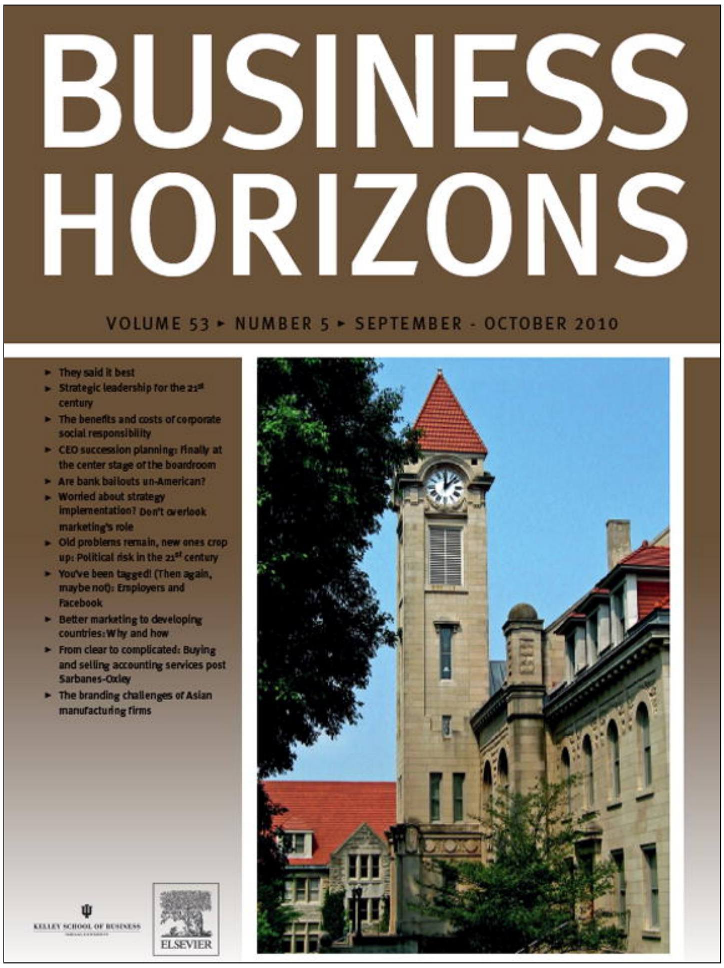
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EXECUTIVE DIGEST

CEO succession planning: Finally at the center stage of the boardroom

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1. CEO succession: A continuing challenge

Few would question the importance of CEO succession in a company's success, but many companies do not have a plan to manage CEO succession. For instance, a 2009 survey by the National Association of Corporate Directors revealed that 43% of U.S. public companies had no formal CEO succession plan and 61% had no emergency CEO replacement plan (Miles & Bennett, 2009). Even among firms that do have succession plans, most of them are dissatisfied with their plans. For example, the Corporate Leadership Council, a human-resource research firm, found that only 20% of the 276 large firms they surveyed in 2004 were satisfied with their top-management succession processes (Charan, 2005). The absence of a CEO succession plan can put a firm at enormous risk. One recent example of a succession-induced crisis is Bank of America. When the former CEO Ken Lewis announced on October 1, 2009 his intention to leave by the end of 2009, Bank of America did not have a succession plan in place. Between September 30, 2009 and December 15, 2009, the period during which the firm searched for a successor to Lewis, its stock fell 10% while the Dow Jones Industrial Average rose 7.6% (Kassenaar, 2010).

The Securities and Exchange Commission's Division of Corporate Finance Legal Bulletin 14E, released on October 27, 2009, holds boards more directly responsible for succession planning. The bulletin is also likely to empower shareholders who want boards to be more transparent in relation to CEO succession planning. The bulletin explicates that:

> One of the board's key functions is to provide for succession planning so that the company is not adversely affected due to a vacancy in leadership. Recent events have underscored the importance of this board function to the governance of the corporation. We now recognize that CEO succession planning raises a significant policy issue regarding the governance of the corporation that transcends the day-to-day business matters of managing the workforce. (Miles & Bennett, 2009)

A likely direct outcome of this change in the SEC's position is that we may see an increasing proportion of inside promotions to the CEO position. This represents a reversal of the trend in the past two decades whereby companies have increasingly favored outside hires for the CEO position. In this article, we will identify the reasons underlying companies' common quest for outside CEOs, compare the relative advantages and disadvantages of inside versus outside CEO successions, and offer

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suggestions regarding how boards of directors can better manage the CEO succession planning process.

2. The quest for the ideal CEO: Why outsiders?

The past two decades have witnessed a trend in CEO succession that has favored outside hires. More than one-third of Fortune 1000 companies are run by CEOs recruited from outside the firm, according to public affairs firm Buston-Marsteller (Charan, 2005). Why have companies been increasingly in favor of outside CEO candidates vis-à-vis internal ones? We discuss the major reasons behind this trend.

2.1. Outside succession = Change = Better performance

Very often, we hear comments like "the firm needs a fresh start" and the firm needs to recruit a new CEO from outside to "shake things up." Firms favor outside CEO candidates because in a popular—but not necessarily correct—view, "outside succession" is equated to "organizational change," which further is equated to "better performance." Generally speaking, CEOs recruited from outside the firm are more likely to make bolder changes than CEOs promoted from within the firm because outside CEOs bring new perspectives and experience, and they are not bounded by prior "social contracts" with the firm's other constituents (e.g., employees). As a result, they are less likely to hesitate to make changes—especially changes such as cost-cutting and employee layoffs.

However, the question needs to be asked: Are bolder strategic changes always better changes that are beneficial to firm performance? Not necessarily. Too often, bolder changes are applauded because they are equated with adaptability and flexibility. It should also be noted that bolder changes can be detrimental to firm performance because they may deviate from the firm's core competence. The disruptive effect of bolder strategic changes can be further amplified if the firm's leadership lacks a good understanding of the firm's strengths and weaknesses, which may lead them to initiate bold but inappropriate strategic changes. Relative to CEOs promoted from within the firm, those recruited from outside the firm typically lack a good understanding of the firm's core competence and a deep root within the firm. While outside CEOs may initiate bolder changes than inside CEOs, the relative performance consequence of strategic changes under their leadership may tell us a different story.

2.2. Inside candidates are just not that exciting

Another reason underlying external CEO successions is related to human cognition bias. Insider candidates, whom you meet in elevators and on coffee breaks, are just not as exciting as outsiders who are most often presented to corporate boards by professional headhunters via star-like résumés and glowing references. While the relative unfamiliarity of outside candidates may make the task of assessing the candidates' capability more challenging, it can still lead to excitement in the board of directors because the outsider presents a tantalizing promise of doing things differently. In contrast, the board of directors' evaluation of inside candidates is very likely to be constrained by the internal candidates' current roles. For example, the board of directors may not have observed an internal candidate's strategic thinking capability because the internal candidate has never had a chance to demonstrate that capability.

As Khurana (2002) noted, the one quality that companies are looking for in new leaders—and seem to value above anything else—is charisma. However, charisma is difficult to define, let alone measure. To play it safe, companies naturally look at candidates who are already senior executives of high-performance and high-status companies; namely, outside candidates. In other words, a candidate's charisma is measured by the performance and status of the candidate's current employer, even though the extent to which his or her current employer's performance and status can be attributed to the candidate's ability and effort remains a question. Therefore, it is not surprising that hiring a charismatic CEO often leads to disappointment or even disaster (Khurana, 2002).

2.3. Underprepared boards and their reliance on head hunters

As the National Association of Corporate Directors' survey shows, many companies do not have CEO succession planning. As a result, when the time for succession comes, the board of directors is not prepared, and therefore has to rely upon external headhunters to search for CEO candidates. External executive search firms are not likely to be familiar with internal candidates. They search in their database and come up with a list of external candidates. External executive search firms work with a number of client firms and may not have a deep understanding of each individual client firm's unique operating context.

Reliance upon external executive search firms for CEO succession contributes to the phenomenon of multiple firms chasing a small number of "charismatic" CEO candidates. Such a quest can have two potentially dysfunctional consequences. On the one hand, the firm may end up hiring a charismatic CEO, even though the CEO's qualifications do not fit the firm's strategic needs. On the other hand, the competition for the small number of charismatic CEO candidates contributes to excessive pay packages that are offered to the external hires to entice them to the firm and to possibly mitigate the personal risk to the outsider should things go wrong in the new position, resulting in an early termination or voluntary departure; see Harris and Helfat (1997) for a discussion of the pay differences between insiders and outsiders.

It should also be noted that due to their self-interest, external executive search firms have a natural bias toward external hires because they do not get paid—or get paid much less—for internal promotions. Also, as their fee is contingent upon the compensation package of the new external hire, executive search firms have a natural tendency to favor expensive outside successors.

3. Consequences of inside and outside CEO successions

A natural follow-up question to the preceding discussion, then, is: What do we know about the likely consequences of inside and outside CEO successions for the firm and for the CEO?

3.1. Performance consequences for the firm

Many studies have found that outside CEO successions, on average, lead to inferior post-succession firm performance as compared with inside successions. Shen and Cannella (2002), for example, reported that outside CEO successions are associated with lower post-succession firm performance than inside CEO successions. To make matters worse, because an outside CEO succession is a disruption to the firm, it is usually followed by turnover of other top management team members. The departure of experienced top management team members can deprive the outside CEO—and the firm—of crucial managerial talent, especially during the critical transition period when the new CEO is developing familiarity with the firm's resources and constraints, and this can further amplify the negative effect of outside CEO succession on firm performance (Shen & Cannella, 2002).

One of our earlier studies (Zhang & Rajagopalan, 2004) compared the performance consequences of relay CEO succession—in which a newly appointed CEO has been in the COO and/or president position and worked with the predecessor CEO in advance of the actual succession event—with the performance effects of non-relay inside successions ("horse race") and outside successions. We found that relay CEO successions, on average, outperform non-relay inside CEO succession and outside successions. This effect was particularly stronger under more challenging succession contexts, as characterized by lower pre-succession firm performance, higher post-succession strategic instability, and higher post-succession industry instability.

We believe that a relay CEO succession process offers valuable learning benefits to both the firm and to the new CEO. On the one hand, the new CEO has the opportunity—prior to actually taking over—to carry out some of the tasks of the CEO position, thereby acquiring and enhancing position-specific knowledge and developing broader leadership skills consistent with the position. On the other hand, the firm can conduct a focused assessment of the candidate's cognitive and interpersonal capabilities, and continuously update its evaluation of whether the candidate's capabilities fit the CEO position. The firm can then use this evaluation to subsequently decide whether or not to promote the candidate. Thus, a relay CEO succession process can reduce the performance risks after succession.

One may contend that the relative disadvantage of outside CEOs is temporary and will disappear over time. It may also be argued that outside CEOs' advantage lies in their ability to break from the firm's past strategies and thus make the firm more adaptive. In our most recent work (Zhang & Rajagopalan, 2010), we examined these issues by studying the tenure histories of 193 manufacturing industry CEOs who stepped down during the 1993-1998 time period. We found that in the first 3 years of tenure, strategic changes under the leadership of an inside CEO and strategic changes under the leadership of an outside CEO yield essentially the same level of performance in terms of return on assets (ROA). However, after 3 years, bold strategic changes under the leadership of an outside CEO are more disruptive and detrimental to firm performance than changes under the leadership of an inside CEO.

What do these findings tell us? For one, newly appointed CEOs—both outsiders and insiders—tend to make changes during their early tenure. They want to signify that their eras differ from those of their predecessors. A recent example can be found in the steps Jeffery R. Immelt took upon succeeding Jack Welch as CEO of General Electric. Although Immelt was promoted from within the firm, he initiated and implemented significant strategic changes quite soon after succeeding Welch. However, it may take years to observe the performance impact of the changes initiated by newly appointed CEOs. Therefore, the relative differences between inside and outside CEOs in terms of the types of strategic changes they initiate and implement, as well as the performance consequences of these changes, are not immediately evident.

However, our research shows that 3 years into their tenure, strategic changes under the leadership of an inside CEO fare much better than changes under the leadership of an outside CEO. When it comes to strategic change, outsiders typically are good at rapid cost cutting and divestment. Also, because an outside CEO is typically brought in when a firm is not performing well, he or she tends to have a walk-in mandate for change. As tenure increases, obvious opportunities for cost cutting and divestment dry up. Inside CEOs, presumably due to their deeper knowledge and understanding of the firm's strengths and weaknesses, are more likely than outside CEOs to initiate and implement strategic changes that can build the firm's long-term competitive advantage and growth. A troubling conclusion from our research is that the disadvantage of outside CEOs relative to inside CEOs is not temporary, and tends to persist over time.

3.2. Consequences for outside CEOs

Outside CEOs also face a greater career risk than inside CEOs. A Booz Allen survey noted that in North America, 55% of outside CEO departures in 2003 were due to forced resignations, compared with 34% of insiders (Charan, 2005). More recently, Heidrick and Struggles International's CEO L. Kevin Kelly estimated that about 40% of executives hired from the outside last a mere 18 months (Conlin, 2009).

In a large-sample, empirical study, Zhang (2008) examined why some newly appointed CEOs are fired after a short tenure (i.e., less than 3 years) and found that under the same performance conditions (both concurrent firm performance and pre-succession firm performance), outside CEOs on average are 6.7 times more likely to be dismissed with a short tenure than inside CEOs. An important reason is that outside CEO successions are associated with a greater level of information asymmetry between the board of directors of the hiring firm and the CEO candidate; that is, the CEO candidate knows more about his or her true competency than the board of directors. As a result, in an outside succession the board of directors is more likely to hire a wrong executive, and therefore has to correct the mistake by firing the CEO after the succession.

The greater career risk of outside CEOs can have two related outcomes, with further adverse impact on the firm. First, the hiring firm needs to pay greater compensation and severance packages to outside CEOs in order to compensate them for their greater career risk. Consistent with this expectation, Harris and Helfat (1997) found that outside CEOs on average earned 30% more non-contingent compensation (salary + bonus) than inside CEOs. The premium is even greater for outside CEOs without industry experience (35%) than outside CEOs with industry experience (26%), because outside CEOs without industry experience face even greater career risk than those with industry experience.

To further reduce their career risk, hiring firms need to pay outside CEOs expensive severance packages in case they are dismissed. A recent famous example is that of Carly Fiorina, the former CEO of Hewlett Packard, who walked away with a severance package worth $42 million when she was ousted in 2005. High executive compensation has become a source of public outrage and renewed regulatory focus, especially after the financial crises of 2008 that brought the U.S. economy to the brink of financial collapse. Expensive severance packages for failed CEOs prompted an even louder public outcry: How can companies continue to pay their failed CEOs so much money while shareholders have lost millions of dollars and thousands of employees have lost their jobs?

Second, as discussed earlier, outside CEOs have greater career risk and are more likely to be dismissed. This may lead to a vicious cycle in the firm's CEO succession process. Zhang (2008) found that if a predecessor CEO was dismissed, the successor CEO is 1.7 times more likely to be dismissed, as compared with a CEO whose predecessor voluntarily left the CEO position. This is because the dismissal of the predecessor CEO often leads to the bypassing of a normal succession process and forces the firm to select another new CEO in an unplanned manner. The board feels pressure to choose a successor within a short time period to fill the leadership hole at the top created by the unplanned departure of the predecessor CEO. But, unfortunately, it does not have the time to groom internal candidates and/or comprehensively search for and carefully evaluate external candidates. Nor does the board have the time and information to investigate the true competencies of the potential candidates. In addition, dismissing a predecessor CEO usually occurs under pressure from shareholders. As a result, the subsequent succession process is driven by the desire to quickly restore investor confidence rather than by a careful consideration of the CEO competencies the firm really needs (Wiersema, 2002). This rush to select a new CEO very likely leads to a less-than-optimal selection and further prolongs the leadership crisis.

Interestingly, then, outside CEO successions, high CEO turnover rate, and short average CEO tenure appear to go hand in hand. According to a Booz Allen & Hamilton study of the world's largest 2,500 publicly traded corporations, the rate of CEO dismissals has escalated to the point that they represented nearly one-third of all CEO turnovers in 2004—a 300% increase over 1995, the earliest year benchmarked (Lucier, Schuyt, & Tse, 2005). Concurrently, the mean tenure of departing CEOs has declined from 11.4 years in 1995 to 8.8 years in 2004 in North America, and from 8.8 years in 1995 to 6.6 years in 2004 globally (Lucier et al., 2005). In other words, the bias in favor of outside CEO successions may have directly contributed to the continuing instability in the corporate suite.

4. Managing the succession process: What should boards do?

The research evidence—as well as a variety of anecdotal examples reviewed in the earlier parts of this article—points to the conclusion that, overall, outside CEOs have greater liabilities than inside CEOs, and outside succession has greater adverse consequences for both the firms and the CEOs themselves. The SEC's new bulletin pushes firms to finally bring CEO succession planning to the center stage of the board room, and provides activist shareholders with a conduit to investigate a corporation's succession planning. However, succession planning is more than one or two names in an envelope; it is as good as the people who manage the planning process. In the concluding part of this article, we identify and briefly elaborate on some critical actions that boards can take to successfully manage the CEO succession-planning process.

4.1. Develop a deep pipeline of executive talent

At a fundamental level, CEO succession planning requires the development of a deep pipeline of executive talent. One of the board's most critical roles is to ensure the existence of a senior leadership development program that spans multiple organizational levels and includes not only top tier management, but also middle managers (Cohn, Khurana, & Reeves, 2005). At the very least, such a leadership development program should include an in-depth, annual assessment of the top three tiers of management, tracking their success on various assignments, identifying their developmental needs, and determining career paths and leadership opportunities that will better prepare them for higher levels of responsibility (Lorsch & Khurana, 1999). While the CEO of the firm will inevitably play the most critical role in managing such a program, the board has to ensure that the program is actually working and conduct an independent, thorough assessment on a yearly basis—if not more frequently.

Our own research also shows that firms with a larger internal talent pool can better manage the risk of CEO succession than those without. In one of our earlier studies (Zhang & Rajagopalan, 2003) we found that the size of a firm's internal candidate pool as proxied by the presence of a separate COO/president and the number of non-CEO inside directors on the board, is closely linked to the firm's choice of an inside CEO vis-à-vis an outside CEO: the larger the internal pool, the more likely the firm will be to choose an inside CEO. However, the presence of a pool, per se, does not guarantee the choice of a good CEO. It is how this talent is nurtured and evaluated that matters, and that is where an active, deep leadership development program can be critical.

Perhaps the most significant indicator of the effectiveness of leadership development programs is the extent to which and how quickly a firm is able to fill important senior-level positions with internal executives. Some firms clearly have done a better job than others in developing an internal talent pool, and thus they can better handle the CEO succession process. At Dow Chemical, a company with well-established leadership development and succession management processes, an internal hire rate of 75% to 80% is regarded as a sign of the effectiveness of the firm's programs for developing and retaining talent (Conger & Fulmer, 2003). The presence of ready and able internal candidates is especially valuable when the firm confronts an unexpected crisis resulting in a leadership vacuum.

For example, when McDonald's CEO Jim Cantalupo suddenly succumbed to a heart attack in April 2004, he had been in the CEO position for just over 1 year. Nonetheless, the board was able to replace him within hours with the pre-agreed successor, Charlie Bell, a 43-year-old Australian. Bell was a McDonald's "lifer," having begun his career with the company in Australia at age 15. When Cantalupo took the CEO position in late 2002, he designated Bell as his heir apparent by promoting him to president and COO. After over just 6 months in position, Charlie Bell had to step down as CEO of McDonald's in November 2004 due to cancer; he died in January 2005. Bell was replaced by Jim Skinner, who also had a long history with the firm. Without a carefully designed succession plan, the series of unexpected CEO turnovers would have resulted in disaster for McDonald's.

Another example of a smooth leadership transition reflecting the careful nurturing of internal talent can be found in the CEO succession process at Wal-Mart. David Glass joined Wal-Mart in 1984 and was promoted that year to the president/COO position as heir apparent to company founder Sam Walton. Glass assumed the CEO position in 1988, and went on to lead Wal-Mart through an unprecedented 12-year period of growth and international expansion. When Glass stepped down in early 2000, he was replaced by his heir apparent, Lee Scott. Scott had joined Wal-Mart 20 years earlier and was named COO and vice chairman of Wal-Mart, in preparation for the CEO position. Because Wal-Mart has consistently groomed the next CEO ahead of time, the transition in leadership has been seamless for this retail giant.

Inside directors on the board of directors represent an important channel to groom internal CEO candidates. The Sarbanes-Oxley Act of 2002 set an upper limit on the number of inside directors that may sit on a company's board. While this requirement helps increase the independence of the board, it can also potentially reduce the internal candidate pool for the CEO position (Dalton & Dalton, 2007). Companies need to find new ways to enable the board of directors to identify and evaluate internal management talent. For example, the board may ask the CEO's direct reports or even managers two or three levels below the CEO to make presentations to board members.

Directors should also meet with and observe internal talents more informally, on a regular basis. The practices at Colgate-Palmolive are worth noting in this regard. An important role played by the firm's senior vice-president of human resources is that of a bridge between directors and high potential executives inside the firm. High potential executives are identified early and often, and detailed analyses of their strengths and weaknesses are shared with board members; board members in turn closely track the progress and performance of the top 200 executives, invite them to make presentations to the board on a routine basis, and meet with them informally over meals (Charan, 2005).

4.2. Set up an effective nominating and search committee

Many governance experts and activists have already argued that CEO succession planning is a primary responsibility of the board of directors, and not that of the CEO or the human resources staff. In addition to ensuring the existence and continued operation of a leadership development program in the focal firm, boards also need to actively manage the CEO selection process through a formal nominating and search committee. Recent research conducted by one of the authors (Zhang, 2008) provides compelling evidence illustrating the critical role of a nominating committee on the board of directors.

Zhang (2008) found that firms with a formal nominating committee on the board are less likely to dismiss their CEOs with short tenure (up to 3 years) than those without a formal nominating committee. However, not all nominating or search committees are effective. Zhang (2008) found that a nominating committee with more focused members—that is, outside directors on the committee have few external directorships; no more than 1.75 per person, excluding the focal firm's board—is more effective. In contrast, a nominating committee with overly committed members—that is, outside directors on the committee have a large number of external directorships; more than 1.75 per person, excluding the focal firm's board—is as ineffective as having no formal nominating committee on the board. Note that outside directors of large companies are either executives of their own firms or professionals. These people experience great day-to-day pressures and constant scrutiny in carrying out their own jobs. If they have too many external directorships, they become stretched too thinly and are unable to devote sufficient time and energy to the focal firm's succession process. This is particularly true, considering demands on the time of a director have dramatically increased in recent years. Therefore, firms with a nominating committee containing overly committed outside directors are not much different from firms with no nominating committee at all.

The expertise of directors on a nominating committee is also important. "Boards would never hire or appoint someone to be chair of the audit or risk committee without specific qualifications, but this has not been true for those that chair the succession process for the company" says Stephen Miles, Vice Chairman and head of leadership advisory services at Heidrick & Struggles ("5 New Trends," 2010). This needs to change: firms must hire people with specific succession expertise to serve on their nominating or CEO search committees.

The presence of industry expertise among members of the nominating and search committees is also crucial, as in-depth understanding of the firm's operating context and competitive conditions will enhance the ability of the committee to develop appropriate position specifications for the CEO job and assess more accurately the fit between potential candidates' qualifications and contextual contingencies (Khurana, 2001). Deep industry knowledge among board members will enhance the effectiveness of the CEO succession process, even if the ultimate decision is to go with an outsider, because such knowledge will enable the board to direct and control the search process even as it uses the services of an external search firm. As noted by Bennis and O'Toole (2000, p. 40), "Headhunters don't typically evaluate leadership experience or potential and have little or no experience in doing so." When the nominating and search committees possess deep industry and firm-specific knowledge, they are better equipped to identify CEO candidates whose leadership skills and experience are most suited to the firm's internal and external operating contexts.

Nominating and search committees need to actively supervise the succession process and spend a significant amount of time examining lists of top candidates in the leadership pipeline, periodically examine and evaluate reports on the entire pool of potential CEO candidates, and devote a significant percentage of the time spent in full board meetings to a discussion of succession issues (Charan, 2005). Such a process will considerably enhance the ability of the board to identify a large pool of internal talent that can be tapped at the time of succession.

4.3. Get the incumbent CEO on board with succession planning

While selection of a new CEO is ultimately the responsibility of the board, the incumbent CEO can significantly influence the effectiveness of the succession planning process, as well as the eventual outcome, because that person is inevitably closer to the potential internal candidates and the day-to-day realities of the firm than even the most well informed board member. Hence, the manner in which the board engages the outgoing CEO is critical.

First, the board should make sure that the succession planning process begins several years before the current CEO is expected to step down. This requires that the current CEO clearly identify and communicate his or her plans to the board well in advance of the actual search process. The board should insist that the CEO identify and evaluate potential candidates thoroughly and regularly—ideally, through a leadership development program, such as that discussed earlier—and share these evaluations on an ongoing basis with the board's nominating and search committees. The board needs to discuss and evaluate the CEO's succession plans in independent meetings, without the CEO being present, and later provide formal feedback to the CEO on any issues and concerns that arise in such discussions (Lorsch & Khurana, 1999).

To ensure the willing and whole-hearted cooperation of the incumbent CEO in the succession planning process, boards have to be sensitive to a major factor that may explain why so many CEOs are reluctant to actively engage in succession planning. While many reasons may underlie the lack of interest about and attention to this issue, an important—and real!—reason that many CEOs will not disclose is FEAR: the fear that a CEO-in-waiting may challenge the incumbent CEO at an opportune time, or the fear that the board's awareness of multiple, qualified internal candidates will reduce its dependence on the incumbent CEO's leadership.

These concerns appear to be validated by recent empirical evidence. A study conducted by one of the authors (Zhang, 2006) examined the relationship between a CEO and his or her right-hand person—a COO/president—and found that the presence of a separate COO/president increases the likelihood of the dismissal of the incumbent CEO when the firm has poor performance. The presence of a separate COO/president is most likely to trigger the dismissal of the incumbent CEO when the firm has performance problems and experiences a high level of strategic change—a situation signaling that the incumbent CEO's experience may be outdated and the firm needs new leadership. The findings of Zhang (2006) show that a COO/president is not always a partner to the incumbent CEO; he or she can be a rival when the opportunity arises.

The incumbent CEO's fear of potential challenge from a COO/president decreases his or her incentive to have a succession plan. For example, Carly Fiorina, the ex-CEO of HP, famously refused to name a COO although the executive board believed a strong COO should be brought in to work alongside her. This disagreement later became a key factor in the board's decision to oust Fiorina in February 2005.

Even having a CEO-in-waiting does not necessarily guarantee a smooth CEO succession process. As found by Cannella and Shen (2001), many heirs apparent leave their companies instead of being promoted to the CEO position, and the probability of heir apparent promotion is particularly lower when the incumbent CEO is more powerful. Therefore, having a CEO-in-waiting may be counterproductive if rivalry between the incumbent CEO and the CEO-in-waiting spirals out of control. The board of directors needs to carefully manage potential rivalry between the CEO and the CEO-in-waiting, in order to avoid this unwanted and adverse impact of CEO succession planning. Perhaps getting a firm commitment from the outgoing CEO with regard to his or her departure date may help mitigate the uncertainty faced by the heir apparent.

For some companies, establishing a mandatory retirement age may help provide structure that facilitates a smooth and timely passing of the baton between the incumbent CEO and the CEO-in-waiting. Ultimately, the incumbent CEO is less likely to feel threatened by the presence of internal competitors aspiring for his or her job if the CEO is an integral part of the succession planning process, is deeply involved in identifying and grooming leadership talent, and is explicitly recognized—and even rewarded—by the board for planning his or her own succession in a timely manner.

5. Concluding remarks

In conclusion, our own empirical research and other available evidence seem to indicate quite clearly that—in the long term—companies can fare better being led by CEOs groomed from the inside, as opposed to CEOs chosen from the outside. However, it is not as simple as that. In many situations, firms are forced to look outside to fill the CEO position because there are no qualified internal candidates for the top post. In order to be able to promote a qualified internal candidate for the CEO position when the time comes, firms need to have a CEO succession planning process in place. Boards can, and must, play a crucial role in this process. While the monitoring and evaluative functions of the board have received considerable attention from both the business press and regulators, it is time to refocus our attention on the most important task of the board: the selection of a new CEO.

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