Your New CEO: The Transition Period

by John Rehfeld

The new chief executive faces enormous challenges, but one of these should not be second-guessing from the boardroom. The board's relationship with the departing chief, the board governance structure, and the new CEO's initial "breaking in" period are all vital factors in making the CEO tenure successful.

It happens every day in boardrooms across America as companies face both internal and external challenges which oftentimes are critical. Products are not selling as expected. Obsolescence is outpacing R&D. Competition is growing. The stock price is in decline or unstable, and shareholders are upset.

All eyes focus on the board of directors, who try to find a short-term fix with hope that it will lead to long-term success. Typically, that "fix" results in a shift at the chief executive officer level. Most often it is the current CEO who is "retired" by the board to be replaced by fresh blood—a handpicked "professional" with an impeccable resumé who is eager to assume the challenges of his/her new post.

The new CEO should do some homework. Was the board largely recruited by your predecessor? Does the former CEO plan to stay on the board?

However, while the problems that put the company into the current situation remain to be solved, another crisis is developing as the outgoing and incoming CEOs attempt to adjust to their new roles, and to the board.

If you are a candidate for the job of incoming CEO, or you just got hired, do your homework. You must have full understanding of your own expectations by the board, and know as much as you can about the situation you will be getting into.

Start by finding out a few important facts: Was the board largely recruited by your predecessor? Is that former CEO a major stockholder? Is he or she planning to remain on the board, and under what terms?

Obviously, your status as the new CEO will be greatly effected by the proximity and influence of the former CEO, especially if the company and CEO transition problems reach crisis proportions. At that time, the founding CEO may decide it would be "best for him/her to return." Why does this happen?

- ☐ *The "good buddy" factor.* Old friends still in the company and on the board constantly remind him/her of how good things used to be, consciously or unconsciously poisoning the atmosphere.
- ☐ *The "hero" factor.* As a major shareholder, he/she believes it is a "God-given right" to come back and save the company.
- ☐ *The "can't let go" factor.* The company is the former chair's life and he cannot stand the loss of control.

An executive who replaced a CEO during a company's stressful circumstances often referred to his predecessor as "the wounded king in the woods" because he did not want to leave the position and became a proverbial pain in the posterior. Do everything in your power to avoid this scenario, including major surgery in the corporate political context.

When I was on the board of a well-known manufacturing software company, the founding CEO was replaced but chose not to stay on the board. After nine months, in the midst of the company's first post-transition financial crisis, the original CEO attempted to return.

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He tried valiantly but could not justify the move with former customers, employees, institutional and private investors and others. His successor kept his job and less than two years later the company was sold at enhanced value.

In contrast, my tenure as CEO at a public company that manufactured digital projection equipment had a different ending.

The CEO who I replaced was an early manager in the firm, held major stockholder status, had hand-picked all of the board members and assumed the position of board chair. He still enjoyed loyalties from board members, some managers and employees throughout the company.

Shortly after my arrival, the company was suddenly challenged by the Japanese giants who controlled the core liquid crystal display (LCD) technology. They decided to make low-cost LCD projectors a strategic product category. We could not replace our products fast enough to keep pace with the newer, lower-priced imports, and our gross margin and stock price dropped drastically.

The former CEO successfully leveraged his position to lobby his original and loyal board members, resulting in his reinstatement as CEO—and my departure from the firm.

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This case points to a common thread between most boards: Although they are well-intentioned, directors are part-time, they are often loyal to the former CEO and they will go to any length to avoid long, complicated problems. Also, their loyalties to the CEO, whether incoming or outgoing, can get in the way of making objective decisions "for the good of the company."

In another boardroom situation, a very competent and professional director contemplated resigning rather than watch his friend, the current CEO, suffer through being replaced by the former CEO. It is a very real dilemma faced every day in many boardrooms.

Since conflict is a fact of life in the corporate world (and in human relationships), the best thing we can do is prepare for the worst and hope for the best. If you are the new CEO on the block, here are 10 tips for dealing with your board and related issues:

☐ *Meet individually with each board member to discuss company issues and problems.* It is essential that you build solid relationships with all directors and that you understand their relationships with the former CEO or founders.

All board members, particularly those from outside the company, greatly appreciate a new CEO finding time to meet one-on-one with them to learn and understand their roles and listen to their opinions.

☐ *Attempt to place executives onto the board who know and respect you.* Equally important, they should be supportive of your management style, philosophy and vision. They should complement your own skills and they should have marketplace/buyer experience.

It is not unusual for some board members to be completely loyal to the departing CEO. In fact, they are usually willing to resign and encourage others to step down. They understand the need for incoming CEOs to bring in new board members who know and respect them. They realize that the new CEO needs to establish a nominating committee of the board and communicate openly with them about his or her goals, strategies and plans.

☐ *Get a lawyer to review your employment contract.* Put aside your excitement and euphoria about landing the new position and keep in mind that the average CEO's job longevity is less than 22 months. You can cut a few months off if the CEO you replaced stays on as chairman of the board.

☐ *Get your severance compensation determined up front.* Use standard CEO severance package benchmarks as your guide, but insist on a 25 to 50 percent higher package if the former CEO remains on the board, particularly as board chair. There are many issues to consider in this case, but stand your ground on severance pay.

Conventional wisdom dictates that the departing CEO should not serve on the board, and definitely not as chairman of the board. However, the departing CEO may well remain. If the board decides to have the departing CEO stay on, it is very understanding of the request for additional severance protection.

The new CEO should take needed write-offs early in his tenure. This tends to bring some fiscal skeletons out of the closet, but will often be accepted by the board.

☐ *Take aggressive write-offs and reserves during your first three months on the job.* This is more difficult if the former CEO is on the board and the previous CFO is still on the job. If that is the case, you need to immediately rally the support of all board members. Ensure that the incumbent CFO puts all the issues on the table. The former CFO is part of the numbers problem and may tend to hide, either intentionally or unintentionally, issues that have not been fully disclosed.

The board may not like heavy write-offs because these will bring the "skeletons out of the closets." However, most write-offs do not severely affect the stock price if the analysts determine that going forward operating earnings met their expectations. The board may fight back, but basically directors understand that taking these write-offs one time (versus leaking them into the future operating results) is a better course of action.

☐ *Seriously assess your management team* and take quick action to put your people in the right places, especially your CFO, who is your "numbers" partner and must be your best friend. This has serious implications if the former CEO left under stressful circumstances and the current CFO is still in place.

The board has most contact with the CEO and CFO. If the CEO leaves, its "contact" remains the former CFO. Therefore, replacing the CFO makes for a difficult decision. In all probability, though, the board will not resist this management change.

☐ *Make sure that the board already has or establishes written performance goals for the CEO.* It is important to align CEO goals with board expectations. I like to call these non-financial goals "key factors for success" that also serve as bonus goals for the management team.

Established in six or 12-month increments, these "key factors" are reviewed and prepared by senior managers, approved by the CEO and the board, and form the basis for non-financial performance measurement for everybody involved.

The board appreciates such solid performance measures. However, in reality such a review does not happen very often. To make it happen at all, or on a regular basis, takes real discipline on the part of the board and the CEO. The board also could do a non-financial goals review of its own performance. Both the process and the results are worth the effort, although difficult to achieve.

☐ *Encourage the board to meet separately from the CEO and the rest of the management team on a regular basis,* though not necessarily at every general board meeting. This ensures that members are comfortable meeting without the management team when an inevitable crisis occurs. The managers will become accustomed to seeing the board meet on its own and will not be worried when the board calls special "emergency" meetings.

If the board meets regularly without management, perhaps every other meeting, it establishes a pattern, a comfort level and a rapport among the directors. This has a positive effect of reducing the concerns among management and outside observers when any crisis occurs.

☐ *Allow ample time for discussion of your overall strategic plans at all board meetings,* including at least one or two off-site "retreats." These meetings are ideal forums for the board to contribute the full value of its collective experience and knowledge. However, they often can be the CEO's nightmare if the board is not "buying" into his/her roadmap for how the company should be moving.

A good board has a unique opportunity to contribute to the strategic direction of the company and each member appreciates the chance to do so. However, more often than not, board meetings become

consumed by presentations of short-term operational and financial issues, leaving little time for member involvement.

☐ *Remember that the board has two major functions: to review and approve the company's strategic plan—and to hire and fire the CEO.*

One of the initial duties of the new CEO, in his or her assessment of the company's performance, management and structure, is to take a stand on whether the CEO and board chairman positions should be combined. Since corporate leadership in American corporations is considered a singular responsibility, combining the two roles may be appropriate.

The new CEO can consider other new "best practice" boardroom ideas as well. According to the experts on corporate governance, there is a trend toward smaller-sized boards, thus making management of board affairs considerably easier and facilitating communication among directors.

Furthermore, your directors should include people who bring a particular expertise, who typically obtain their position because of their familiarity with the company's industry and for their knowledge of finance, marketing or accounting.

Each board member should be assigned specific roles or functions separate from management's. Audit and nominating committees should consist of outside directors only. This ensures that the board will stay focused on its key mission as the company overseers, and has independent access to needed information.

Finally, it is crucial that the board has a CEO succession policy. We have focused here primarily on the issue of "forced retirement," but as the new CEO you must be optimistic that your tenure will be long, and your retirement will be voluntary. Therefore, you should answer some key succession planning questions:

☐ Does the board have a retirement policy?

☐ Is there an appropriate internal candidate for succession?

☐ If so, what steps will be required to strengthen his or her readiness for the new responsibilities?

☐ If not, what is the recruiting profile?

☐ What is the board's consensus about hiring internal vs. outside CEOs? In fact, how does the board feel about using outside consultants to help with the recruiting process?

The new CEO cannot begin tackling the day-to-day matters until successfully dealing with the board, the former CEO, and key management staff.

It is your responsibility as the new CEO to express your opinions and plead your case to the board about how you would ideally like to see the company managed at the board level.

Such leadership skills will determine your fate. How you shape, influence, relate to and work with your board will ultimately decide the company's future.

You will not be able to begin tackling the company's operational, financial and other day-to-day-matters until you successfully deal with your new board, the outgoing CEO and a possibly insecure or fleeing management staff.

There is a big distinction between management and leadership, and the CEO must clearly be the leader. You must set goals, standards and a clear vision of where you want the company to be, even if you are not there yet and are not sure how you are going to get there.

By facilitating open communication throughout the company, working with the board of directors and all key people in the firm to create new services and systems, the company can differentiate itself from its competition and gain greater success.

In today's turbulent business environment, the C-class of management (CEOs, CFOs, CIOs, COOs, *et al)* and the directors can no longer rely on their experience and gut instincts. Instead they must learn as much as they can—as fast as they can—about the increasingly complex world of corporate governance. ■

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