Saving the CHIEF EXECUTIVE

What is the job of the board of directors? To make certain the chief executive succeeds. How does it do it? By working closely with the chief executive in a collaborative relationship.

By Daniel T. Carroll

The popular and perfectly appropriate question about whether boards act promptly enough to remove underperforming chief executives seems to have crowded out any consideration of the cost of both the removal and the replacement. Also unasked is whether there was a time when that cost could have been avoided in the first place.

Each episode of replacing a chief executive officer has its unique set of characteristics and costs, of course, but almost none is inexpensive. The outgoing executive will have severance arrangements that are rarely avoidable and just as rarely modest. Typically, there will also be the expense of a search firm to find a successor. When that person is found, a hiring bonus or a guarantee of a first-year incentive may be needed to close the deal. Then there are the relocation costs. And the new person usually will have to get a bigger compensation package than the previous chief executive received. After all, the new chief executive presumably will have been induced to leave what was a promising situation and is now expected to do better than the failed predecessor did.

There is still more. Beyond these rather obvious costs will often be expenses related to the people who must be severed because the new chief executive does not need or want them. Then, too, there are the expenses to cover new managers whom the new chief executive sees as vital to returning the company to a more successful state. Those new managers in turn will have their own ideas about who goes, who stays and who must be hired.

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For most boards, all these costs will be treated as a well-accepted fact of corporate life and thus something to be put behind them and forgotten. If there are any second thoughts, they will usually take the form of regrets that the board did not act sooner. It is highly unlikely that anyone will wonder whether the board, with a little foresight, might have saved its underperforming chief executive. Similarly, there is scant consideration of the distressing possibility that it is now too late to restore the business to acceptable health or that the successor will do no better.

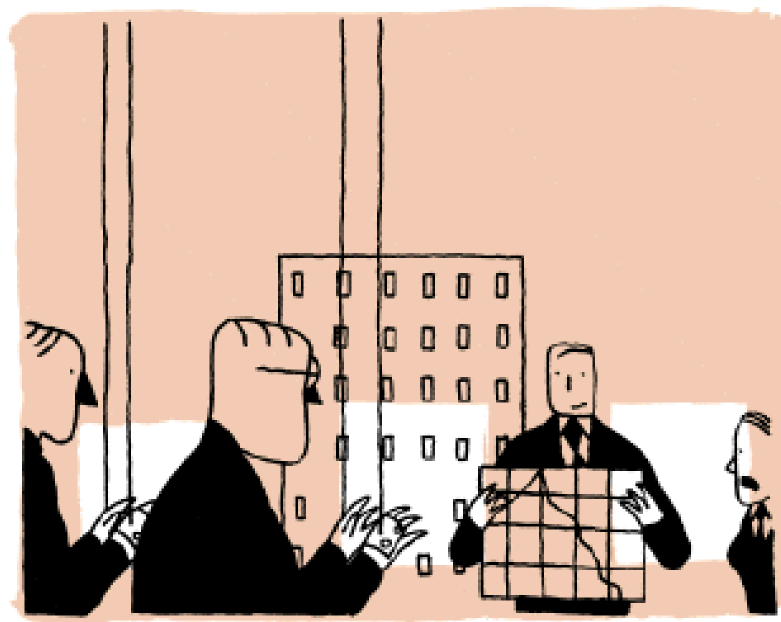
Apart from an understandable desire not to revisit the unpleasantness of dismissing someone who had once been a respected colleague, the directors will usually be of two minds about their responsibility for what happened to the chief executive.

On one level, the directors are accustomed to believing that chief executives are the masters of their own fates and that their input is neither welcomed nor particularly well informed. Put somewhat differently, they believe that a person qualified to be the chief executive ought not to require a guidance counselor or coach.

On another level, though, those directors who might wish to help will often be confounded by the absence of warning signs that are early enough to give intervention a serious chance of succeeding. The traditional signs of missed budgets, a continuing stream of onetime write-offs, an eroding market share and a substandard stock multiple will almost always come too late.

Since the underlying errors and behavior that caused the missed budgets, write-offs and the like will have been longstanding, the shareholder audience is likely to have become sufficiently aroused and vehement that saving the chief executive will be an option open only to the most sympathetic of boards. Any such board will also have to be capable of turning a deaf ear to the outcries of analysts and institutional investors. Given the almost congenital dislike of directors for publicity, particularly of the adverse kind, any tendency to be sympathetic will not endure for long, certainly not long enough in most cases to have a recognizable impact on the chief executive's behavior.

Fortunately for chief executives who might be saved and for the boards interested in saving them, warning signs *do* exist that are early enough to help. To be sure, these signs deal much more with symptoms than with the actual disease. As a consequence, they alert boards and chief executives to the possibility that a performance problem may exist, but they do not define in any useful way the extent of the problem or its remedy.



Because these signals are so sketchy, directors and chief executives who content themselves with correcting just the symptom can be lulled into thinking that all is right when it is not. The unintended consequence in that case may be to hasten the process of failure instead of bringing it to a halt.

Handled skillfully, however, these

Illustrations by Laurent Cilluffo

early alarms can sometimes save the day. Indeed, together with other forms of flashing red lights, these indicators of impending trouble could give a sensitive and sophisticated board and a self-aware and cooperative chief executive enough lead time to avert failure and the costs that inevitably follow in its wake.

One category of early warning signs involves matters that are generally thought of as removed from the inner workings of the company. A particularly significant example of these so-called external signals occurs when chief executives quietly — or not so quietly, for that matter — argue for fewer and shorter board meetings. While these executives may feel unreasonably deluged with meetings, they will more often than not be signaling their frustration with board intrusions on their time and energies, and especially their "turf."

Until and unless the directors are able to confirm that the meetings have in fact become an unreasonable burden, they should assume that they are dealing with a chief executive who is uncomfortable with their oversight and who as a result is attempting to withdraw into the company.

The superficial and wrong solution would be simply to refuse to shorten the length or number of board meetings. Instead, the directors should view this as an early warning sign and use it as a way of understanding why the chief executive is troubled with the board and to learn what he or she is uneasy about discussing or disclosing. Helping the chief executive over this particular difficulty will certainly not remake the individual into a fully functioning and successful chief executive. But it can open up a dialogue, which permits the board to become the counselor that the chief executive may desperately need at this time.

Another external warning sign involves the chief executive's refusal to consider board candidates who have a reputation for being outspoken and who might be quick to criticize the chief executive's actions. That sign may also take the form of the chief executive insisting on board candidates who are cronies or who would be considered non-threatening. Sometimes, both forms of this behavior are present.

Once again, the board can be arbitrary and overrule the chief executive. By so doing, however, it may miss an opportunity to identify and deal with the chief executive's concerns and anxieties. It goes almost without saying that those concerns and anxieties will rarely be confined to who is, or is not, selected for board membership.

A corollary of this last warning sign is the manipulation by the chief executive of the membership of key board committees, particularly when it comes to deciding who serves as chairman.

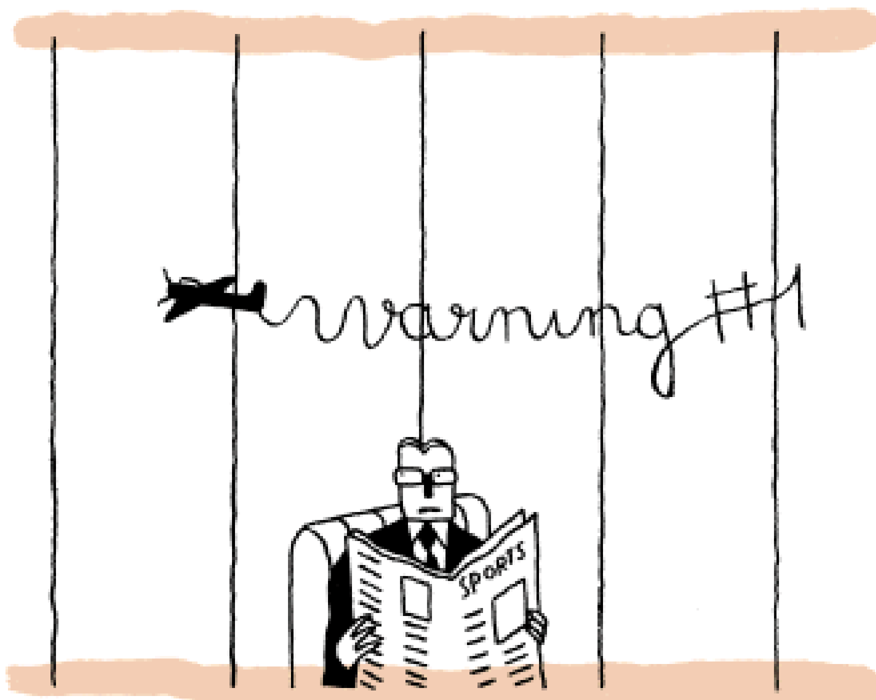
The secure and successful chief executive will more likely than not be indifferent to the makeup of committees, delegating those matters to the nominating committee or to the board itself. But chief executives who are in trouble, or are about to be, will not leave these things to chance. Instead, they will maneuver subtly and sometimes not so subtly to get a sympathetic director to serve as chairman and, if possible, to corral enough supporters to constitute a majority.

This is particularly the case when it comes to the compensation and audit committees. It will not take any chief executive long to sense the sometimes fatal importance of the compensation committee, which, in addition to approving salaries and the like, will inevitably be drawn into appraising the performance of management. Similarly, the audit committee, with its private access to the company's external and internal auditors, will be alerted to problems sooner and in greater detail than insecure chief executives will like.

One final external warning sign involves the steady erosion in the number of security analysts who follow the company and a corresponding rise in the financial relations budget, which is designed to stem that erosion but usually proves to be an exercise in throwing good money after bad.

Whatever may be said for and against analysts, they have limited time and resources and thus do not decide to follow a company frivolously. Nor are they likely to abandon one without some real provocation, which usually takes the form of a series of disappointing results. Underperforming chief executives will often explain away a departing analyst as someone who never understood the company or who has a record of rapidly moving into and out of companies. Even in the case of superbly performing chief executives, board members are well advised to know which analysts follow the company and to bring more than a little curiosity to bear when one or more of them decide to drop their coverage.

Moving from external signs to management signs, the most deceptive and distressing early warning signal is the chief executive's reliance on his or her "vision statement." Truly competent chief executives recognize that vision statements are simply a useful first step in defining strategy. For them, a vision statement requires a strategic sequel and thus is not something that stands alone. Conversely, chief executives who have no strategy or who have one that has no real chance of success will frequently seize upon a vision statement because it has some currency among business schools and consultants and, more importantly, because it offers the possibility of buying time.



These chief executives are likely to be eloquent in describing the long hours that many people contributed to the writing of the statement and the total commitment with which the vision has been received throughout the company. Directors, however, have to remember that commitments are easily given by people who don't relish unemployment. When no effort is made to move beyond the vision statement, the board has to consider that an early warning sign has been lit.

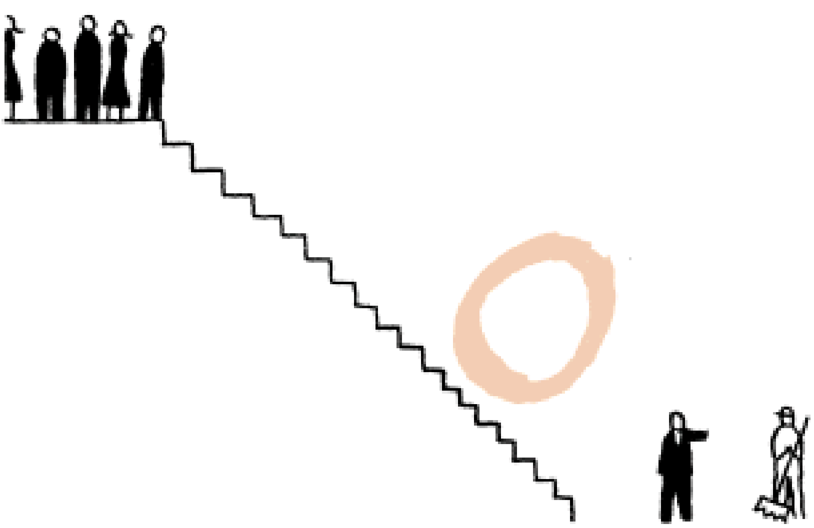
A similar sign can be the excessive dependence on management consultants. Corporations continue to make valuable use of consultants, but weak chief executives, whether they realize it or not, can become so addicted to consultants that they are effectively elevating consulting advice over the internal decision-making processes. Subordinate executives will increasingly resent this elevation, but they are likely to find it difficult to object to still another and presumably more objective opinion about a serious matter.

While it is difficult for part-time directors to distinguish between legitimate, purposeful consulting assignments and those that are not, the assignments can be seen to graduate into an early warning sign when the consulting firm never departs, when it is always positioned as the ultimate authority and truth-teller or when it is known more for its many studies than for any yield coming from those studies.

A management sign that can often be missed will be the shift from measuring company performance against budget to measuring it against the prior year. At the outset of the fiscal year, both budget and prior year will be shown in the financial statements and in the presentations to the board. If results fall steadily below budget as the year progresses, the written communications and the periodic comments by management move first from a budget comparison to a comparison with both budget and prior year and then to a comparison with only the prior year.

In extreme cases, of course, even the prior year becomes an unforgiving reminder of poor performance, but by then the usefulness of this early warning sign will usually have been wasted. In contrast, a board that has recognized the sign will be much less likely to be deterred by the usual rhetoric about overly ambitious budgets and a radically changed economic environment.

market participants. They are also likely to hear about niches within the market that are not measured but in which the company is described as excelling. Not having previously heard or known about inaccuracies, questionable reporting and stealth niches, a board can assume it has received an early warning sign. That is especially the case if it can be established that security analysts and competitors continue to respect the usual market share information.



A related management sign is the dismissal of market share as a measure of performance. In good times, the market share data will be heralded as an exceptionally accurate portrayal of company or product performance. When, however, those good times come to an end or are found to have never really existed, boards are likely to hear about market share inaccuracies and suspect reporting by

Chief executives who recognize that they are in trouble will frequently go out of their way to blame subordinates for the unhappy circumstance of the company or alternatively to excuse or defend the underperformance of those subordinates. The rationale for the first is obviously to excuse the chief executive and at the same time to offer up one or more victims. In the case of the second, the rationale is a bit more complex. Essentially it is based on the hope that if subordinates are excused, so too will be the chief executive.

As far as boards are concerned, the savaging or the defending of subordinates has to be considered a serious warning sign. Chief executives worthy of the name will praise deserving subordinates to the board but will never identify them with failure or disappointment.

A less certain but still important warning sign is the unexpected departure of management people of promise. Some obviously will leave because remarkable opportunities come their way, and some will leave because they wanted to move faster than was possible. That said, it is an unfortunate and ultimately a vulnerable board that accepts unquestioningly the explanations for each departure. The truly able managers will sense early on when their chief executive cannot lead or deliver better results, and it is these managers who quietly find ways to depart and as a result should become early warning signs. Directors may think it underhanded or deceptive to query a departing executive who had previously shown promise, but those board members who recognize the importance of early warning signs and particularly this one will soon overcome their reluctance.

Still another sign of trouble is the steady coming and going of popular management programs. T.Q.M. and reengineering and others like them have been given much visibility and at least as much commitment by the managers who choose to adopt them. The point at which these programs become an early warning sign occurs when each is succeeded by another without any demonstration of success or failure.

Underperforming chief executives will usually fail to appreciate that these programs come alive and produce results only when there is active and continuing leadership by top management. Thus, when instant success does not happen, the chief executive reaches for the next management "medicine" and once again hopes that success will miraculously occur. The sooner a board recognizes a pattern of heralded and then aborted initiatives, the more useful will be this early warning sign.

A final management sign that is often recognized too late to be of help is the growing presence of management by committee. A chief executive who has ceased to lead, or perhaps never led, will find comfort and something of a "security blanket" in committee management. Decisions no longer are made by individuals, but instead by a permanent or ad hoc group. By the same token, responsibility rarely falls on a single manager when a group will do.

The rationale for committee management resonates well with some directors because it is described as a way of bringing along younger and more promising executives or because committees are said to provide a valuable forum for gathering divergent views. What is missing, of course, is any personal commitment or obligation and usually any capacity for decisive action. It is unfortunate that committee management, like cancer, grows slowly and thus is overlooked or discounted in the beginning. But also like cancer, it can become a fatal ailment, which can overwhelm not simply the chief executive who conceived and nurtured it but sometimes the corporation itself.

Still another class of warning signs reflects the personal behavior of chief executives, or more accurately their altered behavior. One such sign is an excessive preoccupation with compensation. At first, there will be an almost imperceptible shift away from ongoing business matters to concerns about the competitiveness of executive compensation. This particular shift is usually explained or excused on the ground that only with equitable salaries and a reasonably attainable incentive can the management team be expected to stay together and deal with an increasingly difficult competitive marketplace.

At the outset, the board's compensation committee is unlikely either to see or to sense anything sinister in the chief executive's sudden concern with compensation. When, however, this concern does not end with a compensation consultant's assurance that all is well or that with a bit of tweaking all will be well, it is time to recognize the flashing red lights of an early warning signal.

Although the implications of this signal will vary with each company and each chief executive, there are some common threads. More often than not, the preoccupation with compensation reflects the failure of whatever were the chief executive's plans for the business and an inability to conceive of an alternative that might offer better prospects. Compensation is thus elevated to the level of business strategy, with the expectation that money now and the possibility of more later will prod executives to work harder and smarter.

Usually unasked is why the harder and smarter ethic is not already in place and whether compensation can ever be expected to generate leadership. Put somewhat differently, incentives can in the short run increase the energy level, but solutions to consequential business challenges almost always require ingenuity and a willingness to lead and take risks. And none of those qualities has much to do with energy.

A more cynical view would be that underperforming chief executives see themselves threatened and hence want to bolster their compensation so that their exit is as financially rewarding as possible. Since none will ever admit to this motivation, it is not possible to identify the villains or the compensation committees that were deceived. There are, however, a surprising number of failed chief executives who received raises immediately before their removal and who were paid handsomely in the aftermath of their departure, even when their companies were left in much-reduced circumstances.

Another of the behavioral signs surfaces when the chief executive's personal agenda is slowly but significantly changed. Where he or she was once almost wholly focused on the business at hand, there now are intrusions — everything from serving on other boards and making bigger commitments to civic groups and industry associations to spending more time at a vacation home or doting on a "trophy spouse."

As might be suspected, these departures from the norm at first are negligible and beneath criticism. Indeed, unless they escalate rapidly, they can go almost unnoticed. The sorrow of it all is that caught early enough, these kinds of transgressions can sometimes be brought to an abrupt halt. Caught late, not only is the habit hard for the chief executive to break, but the board probably has lost some degree of its initiative. In any event, it is now dealing not with an early warning sign but with a chief executive who is about to fail and who will be surprised to learn that the board is upset with his or her altered agenda.

Then there are the chief executives who develop an "edifice complex." Although there undoubtedly are superior chief executives who decide responsibly to build a new corporate headquarters or similar structure, there are a number of others who unexpectedly and suspiciously decide that the old building has outlived its usefulness and needs to be promptly replaced. If the superior chief executives are concerned about getting a return on the investment and even about alternatives like leasing space, the suspect chief executives focus on the elegance of the new structure and its esthetics. When challenged, they dismiss cost measures and trade-offs as irrelevant and as misunderstanding the public relations value of constructing a prominent building. For them, the structure announces success.

Unlike the altered personal agenda, which, if sensed early enough, can sometimes be brought back to reality, the "edifice complex" seems to be incurable, largely because it surfaces so abruptly and is so visible in and out of the company. Chief executives, both good and bad, have never been known for their readiness to back down from what appears to be a public statement or commitment, and a new corporate headquarters is typically high on the list of things that are hard to give up.

Another of the behavioral warning signs is a sharp decline in the chief executive's grasp of the financial and operating details of the business. Formerly able to supply quick and accurate answers to board queries, the chief executive now often defers such questions to the next meeting or deflects them to a subordinate officer.

Some of this altered behavior can understandably and legitimately be charged to the enormity of the company's difficulties and the chief executive's need to focus on particular projects or remedies. But when a chief executive is headed toward failure, behavior of this sort more often reflects a confused and ever-changing agenda and with it a declining ability to use time efficiently. In the end, these chief executives will be so poorly or uncertainly prepared for board meetings that directors will turn instinctively to other officers for answers to their questions.

Having ready access to other officers does have the advantage of moving the meeting along and at the same time sparing the chief executive some embarrassment. In reality, however, it does not spare the board, which belatedly must recognize not only that it has a failed executive on its hands but also that an early warning sign has long since been wasted.

An almost tragic early warning sign is the failing chief executive's propensity for diminishing his or her heirs apparent. Chief executives who sense that they are threatened will too often seek to enhance their indispensability by reducing the readiness of any heirs or sometimes by removing an heir altogether. Their obvious and reprehensible logic is that a board will think twice about removal if its only alternative is an external search, which will be costly, time-consuming and might not yield a better answer.

The penalty for missing this particular warning sign is less the reduced possibility of retrieving the failing chief executive and more the loss of promising heirs. If they are exceptionally talented, they will have sensed their declining fortunes and moved on to more promising careers.

A final personal warning sign is the increasing delegation of key decisions upward to the board. In its early stages, this process will be described as a way to take greater advantage of board talents or as a medium for bringing the directors "on board" with regard to particularly difficult issues. So long as the delegation is used sparingly and with demonstrably consequential matters, the directors will have little reason to be concerned and may even enjoy this greater involvement.

But when the quality of issues declines and more routine subjects are brought to the board for a decision, typically without a clear recommendation from management, the directors should sense that what was a caution light has turned to "red." Not only has the chief executive ceased to lead, but he or she is endeavoring to shift the burden and conceivably the blame to the board.

An unthinking board may be relieved that it is now able to "make things happen," but a more aware and distressed board will quickly recognize that it is no substitute for a fully functioning chief executive. The unthinking board will have utterly missed the early and late warning signs, and the aware board will know it is dealing with a failed chief executive and that time is running out.

In the universe of chief executive officers, there probably exists a normal distribution curve. At the lagging edge are the small percentage of those who had the lead time to make the company succeed and wasted it or who never should have been selected in the first place. At the leading edge are those remarkable performers who go from one success to the next and who bring along successors who they expect will outperform them.

In between are the many whose credentials are less certain and whose performance lurches periodically up and down. It is these many to whom early warning signs can prove to be a blessing. Whether a sign actually will be that blessing, however, depends upon the board members' ability to sense the warning and then to deal promptly with whatever it is telling them.

It will be tempting for even the most sensitive boards to regard their role as simply one of communicating the warning to the chief executive. Beyond that, most boards are likely to conclude that it then is the chief executive's responsibility to deal with his or her lapses.

The harsh reality, however, is that chief executives who have provoked an early warning sign will need more than one nudge from the board, and maybe even several rude shoves. After all, chief executives, good ones and bad, come well endowed with self-confidence, which tends to make them unaware of their failings, particularly when those failings only qualify as early warning signs. In the end, chief executives who might be saved will only be helped by board members who recognize that the task involves, first, communication and then clear demands for altered behavior.

Demands are difficult for a board to agree upon and even more difficult to deliver, but without them the warnings will be wasted and the saving will never happen.

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