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Why Your Next CEO Should Come from Inside

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Why Your Next CEO Should Come from Inside

Harvard Business School professor Joseph L. Bower believes that only homegrown leaders have the sense of history and respect for culture to bring companies through major transitions. But not every insider is up to the job.

by Steven Wheeler

Although the tenure of a chief executive may last anywhere from one to 20 years in large global corporations, the first few years, Joseph L. Bower suggests, are crucial in setting a new direction. In his new book, *The CEO Within: Why Inside Outsiders Are the Key to Succession Planning* (Harvard Business School Press, 2007), he says that to drive strategic change, a CEO needs to understand the company's capabilities and the major forces affecting it. There aren't years to figure out where the world is headed. (This sense of urgency fits with Booz Allen Hamilton's annual study of CEO succession, which finds the average CEO tenure is just under eight years.)

How can companies best ensure that they will put the most qualified person in the top job to hit the ground running? Based on more than 40 years of experience and study of boardroom and executive suite dynamics, Bower, the Donald Kirk David Professor of Business Administration at Harvard Business School, shows that insiders often miss the need for fundamental change whereas outside candidates — although they may bring fresh perspective — lack the knowledge of the company's people, technology, competitiveness, and culture that are crucial for success. The answer lies in cultivating Inside Outsiders — individuals with a deep understanding of the company who aren't afraid to question the status quo.

Bower sat down with Booz Allen Hamilton Senior Vice President Steven Wheeler in the firm's New York offices in November to discuss his recommendations for effective succession management.

S+B: How does CEO succession reflect a company's culture and the discipline with which it is managed?

BOWER: For a departing CEO, the natural tendency when you're thinking about your successor is to look inside. These are the people you know. They know the business, the organization, and its people. You want to reward them because they've helped you. These are all good criteria for judging an individual, but they don't add up to an appropriate way for a company to manage succession. Instead, the incumbent CEO and the board have to consider several key questions: Where is the business headed? What challenges does it face? Has the company developed a cohort of potential leaders — so that when it comes to decide which insider wins the race, it is clear that the winner is talented enough to lead in the future, not just better than the other candidates?

Managing a succession well means managing your company so that people who are moving up in the organization are constantly learning to lead, and are consistently being groomed. This is a central theme of my book: Succession is a process rather than an event. The ingredients of a succession process involve thought-

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ful recruiting and assignments that test managers, build strengths, and expose weaknesses. There must be very careful, regular evaluation and feedback that is fair and transparent. And all that takes a lot of discipline.

We know of some giant "people factories" like GE that do this kind of executive development well, but all companies can manage for talent development if they are willing to invest. One US$2 billion company on whose board I sit has a "talent war room," with the management organization of each of the company's businesses arrayed around the walls. Each manager's potential and performance is written on a card, which is attached to the wall with magnets so it can be moved. They color code the rankings, so that it is easy to see by division who is ready to advance, and who is not performing. This room enables comprehensive reviews of the talent that is available, and the talent that is still needed. It demonstrates that the leaders of this company are willing to invest the time and effort to think practically about the company's future.

S+B: Who are the "Inside Outsiders" of your book's subtitle?

BOWER: Inside Outsiders are managers who have "grown up," professionally, at the company, who have developed an intimate understanding of its strengths and weaknesses, and who respect its culture. Yet they have also managed to remain objective about the company and skeptical of any self-serving ideology. That means they are willing and able to question the received wisdom. They are clear about the need for real change.

Jack Welch is an excellent example of an Inside Outsider. He had spent his career at GE and had earned a reputation as a strong and effective manager, and yet because of his education (he earned a Ph.D. in chemical engineering), his background building GE's plastics business (not in GE's core), and his assertive manner, he perceived himself — and was generally perceived by others — as a maverick. But his unique perspective enabled Welch, within the first few years of his new role, to take apart much of the staff and systems that his predecessor had put in place. Welch is perceived as very aggressive, and his efforts were transforming, but he did it in a way that worked for General Electric. He is famous for demanding that every GE business be number one or number two in market share. If not, the company would "fix it, sell it, or shut it down." In a metric-driven company like GE, that simple directive provided clear guidance for business leaders. And they responded. During his 20-year tenure as CEO, GE's market cap grew by 6,000 percent.

When Edwin Artzt, in the early 1990s, tried to change Procter & Gamble in the way that Welch did at GE (Artzt's efforts included a restructuring that closed one-fifth of P&G's factories and dropped 13,000 people), it didn't work. I've been told that his methods just didn't fit P&G's way of doing things. One manager told me, "He knew what had to be done, but [despite a career at the company] he came at it as an outsider." This is the counter case: an insider who knew what needed to be changed, like Welch, but who failed because he couldn't do it in a way that exploited the strengths of the culture.

S+B: How can a company identify and develop potential Inside Outsiders?

BOWER: I think a central dilemma in managing succession is that the insiders tend to buy into the underlying premises of the existing strategy in the deepest way. They may not even be conscious of it, but it's part of their DNA. This can be crippling, because it prevents them from seeing the need for change. And yet if you have a disciplined process of talent development the potential is there for some of the insiders to be groomed into truly outstanding CEO candidates.

It's not that hard to identify these potential Inside Outsiders. But it is hard to develop them into great leaders and to retain them in the organization. The first thing you look for is intellectual integrity. You need someone who is willing to confront all situations, even the disagreeable ones. That's pretty rare. You don't necessarily want a maverick, but you want someone tough enough to face facts and speak out about them effectively. For example, [former American Express CEO] Harvey Golub says that the first time he recognized Ken Chenault's potential to become his successor was during a discussion that Golub was having with senior executives about problems the company was facing. Chenault was the only one to stand up and lay out the issues — despite his immediate bosses' wishes. He demonstrated integrity and courage, and Golub took notice.

But to be great leaders, executives need to go beyond diagnosing what's wrong. These leaders have to really understand what's feasible given the people that they have. They will be called upon to initiate change and manage risk by pushing and stretching their people, but not breaking them, not fomenting a revolution, and not leading people to do things that are destructive. It's fascinating to watch a significant organizational change unfold. From the outside, the process looks like revolution. But the leaders themselves move cautiously, trying hard not to lose their organization's trust. Later, looking back, they often conclude that they were too cautious — that they could have been bolder still. When our students [at Harvard Business School] asked Jack Welch what his biggest mistake was at GE, his response was, "I didn't move fast enough." And yet at the time, most observers felt he moved at breathtaking speed.

Part of these leaders' effectiveness comes from being mentored well. Often, when you're young, you don't know how to challenge the status quo. You just get everybody angry. You're regarded as a Cassandra or not a team player. Building Insider Outsiders requires an enormous investment of money, time, and patience — especially of the incumbent CEO. Mentors need to recognize when a young executive has an unusual, objective perspective, and should encourage and nurture this quality over time through a carefully chosen sequence of assignments that builds and tests a wide range of capabilities.

S+B: In your book, you talk about the need for "creative abrasion," and you also say that one key criterion is competitiveness. How do you strike a balance between competition and teamwork?

BOWER: I think part of it is asking, competitive against whom? With whom? I didn't become an effective leader until I learned to stop competing with my peers. Some managers have to learn that their job is to compete with external competitors, and that the way you do that best is to help your peers succeed. I think one of the reasons athletes from team sports do relatively well in business is that they've learned that. They know that you don't get to lead without knowing how to work with others. The other day I was listening to the [New England] Patriots players interviewed after they beat the [Indianapolis] Colts. They all sounded like coach Bill Belichick. "Oh, it's a great team." Not one of them took personal credit.

Leaders need to manage the planning and budgeting processes so that these become opportunities for rising executives to learn how to review and develop strategy. These are also occasions to look at new businesses that help executives see it's possible to think differently. Sometimes that requires bringing in diverse kinds of people. We have a wonderful case on a woman at IBM who was given the job of building the company's network technologies business. She took it to $3 billion in two years. She was a very different kind of person from what IBM was used to, although she was an insider. But they were clever enough to give her that responsibility and to mentor her well, and she learned a lot in the process. And so did the company.

The employee in this case assembled a team of people just like her to grow the business quickly. Yet later she had to bring in exactly the sort of person that she had left out, but who knew how to manage complex processes. And she talks about learning how effective it was — how problems suddenly disappeared because the new person brought order where there was unnecessary chaos.

One professor at Harvard Business School refers to the benefits that come from the interaction of different skill sets and personalities as "creative abrasion." Great leaders understand that there is strength in recruiting for diversity so that teams of insiders never get a monolithic view of things. The melding of those different perspectives drives creativity.

S+B: Given the news events of the last few weeks in particular and the turnover in financial services, what can we learn from the recent run of sudden successions? And what can we glean that's not obvious?

BOWER: Based on press accounts of Merrill Lynch and Citigroup, I would say that we have very large, complex organizations now operating in the financial sector. They are tremendous in scale and scope. The job of running them is immense. These institutions are under enormous pressure to perform short term. Managing the balance between short-term performance and risk management and building for the long term is complex, and is probably beyond what one individual can fully oversee as CEO.

There need to be teams working together that can discuss all the dimensions of the problems facing the firm. It certainly seems in this instance, in both cases, that risk management really broke down. And it's not clear to what extent the teams were working to control that process. We appear to have firms that were focusing mostly on delivering results. Merrill's drive for profits and Citigroup's immediate need to deal with scandal seem to have taken priority over long-term risk management. When we look around, we can see that, apparently, most financial institutions have some garbage on their balance sheets. The ones that are getting hurt are those that didn't recognize that early enough and start hedging against it.

It's discouraging that, at each of these companies, when the board of directors decided the circumstances required changing the CEO, there were no obvious inside candidates to choose. That is the dilemma facing companies that haven't thought enough, in advance, about developing the executive talent they will need. +

Resources

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