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The way up and the way down are one and the same.

—T. S. Eliot

Over the past decade more and more stories like Nike's have appeared in the business press—stories about companies that chose leaders who had been highly successful in another setting but who did not succeed in the new one, *in spite of* the best intentions of everybody involved. Furthermore countless stories of a similar nature never reach the public eye, as evidenced by the statistics regarding executive turnover and failures.

The intent of this chapter is to put the facts squarely on the table and understand their impact. To do this we will focus on the following key areas:

- The facts about C-Level failures and the resultant turnover rates occurring today
- The costs of executive turnover to corporations
- The costs to the individuals who are involved
- The Traditional Selection Process through which today's leaders are chosen

Much of the data we will present pertains to chief executive officers specifically, because they receive most of the attention and media coverage. Reports and other data sources for executives further down in the organization are simply not publicly available to track. However, it is our assertion that the factors that can be seen clearly in the CEO data also apply, in general, to their direct reports and other senior executives as well.

The Rising Rate of Leadership Failures

From the data that is available, it is fairly evident that during the last half of the 1990s turnover rates of CEOs of major North American corporations was consistently in the 10 to 11 percent range or lower. In the last five years (2003–2007), however, the average turnover rate has jumped to 14 percent—nearly a 50 percent increase.¹

Looking beyond the big, public corporations, the trend is the same, only worse. According to Challenger, Gray & Christmas the number of CEO departures in the United States for the three-year period from 2005 to 2007 averaged nearly twice that of the preceding three years. The increased departure rates for U.S. CEOs can be clearly seen in Figure 1.1. By mid-year 2008 the turnover rate was again on the increase.²

To place today's "churn at the top" into even sharper focus, additional statistics indicate that 64 percent—nearly two-thirds—of U.S. CEOs fail to

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achieve the objectives for which they were brought in and are replaced or “retired” within four years of their appointment.³ Forty percent are gone within eighteen months.⁴ Moreover, CEOs are being held more accountable for their results as performance-related terminations have increased by 318 percent in the past ten years.⁵

For those who are promoted from within the organization, the odds of success do not dramatically improve as conventional wisdom would lead us to expect. In fact leaders newly selected from within an organization don’t seem to perform any better than those who come from the outside. Data shows that during their first five years in the position outsiders actually outperform inside appointees for those who manage to stay that long.⁶

Also belying conventional wisdom is that fact that prior CEO experience does not apparently help increase the chances of success either. In 2005 the percentage of sitting CEOs who had prior CEO experience when they took their current positions was approximately 37 percent.⁷ Yet that same year, 35 percent of the CEOs who left office due to performance issues were from that very same group.⁸ If prior experience had any appreciative value, then the failure rate of this group should have been significantly lower than those who had not had any previous CEO experience, but that was not the case.

As a result of all this turnover at the top of the house, by the end of 2006 nearly half of the CEOs of New York Stock Exchange (NYSE) member companies (46 percent) had less than four years of on-the-job experience and a

quarter of them (26 percent) had been in the role less than two years.⁹ Since 1995 the tenure of sitting CEOs of public U.S. companies has fallen from ten years to seven years by 2001,¹⁰ and to five years by 2007.¹¹ Alan Murray, editor-in-chief of the *Wall Street Journal Online* concisely summarizes it: “The tenure of CEOs is getting shorter each year.”¹²

At this rate America will soon have the most inexperienced cadre of corporate leaders of any developed country, and some boards will even feel as though they are engaged in two cycles of succession planning simultaneously. As the tenure of CEOs drops below the lead times required to conduct a meaningful succession and grooming plan, they will have to start looking for the successor’s successor at the same time they are looking for the successor. Clearly, something is terribly wrong.

What’s more, the problems of turnover at the top are not limited just to the United States. In 2007 the turnover rate of European CEOs hit a record high of 17.6 percent, significantly higher than the North American rate of 15.2 percent.¹³ Tenure (time in the job) is also low globally. According to a survey conducted in March 2008 of 378 market-leading companies from around the world, a staggering 41.5 percent of CEOs have held their positions for three years or less; 17.6 percent were under a year! To top it off the 2008 study reported that high turnover rates permeated the entire C-Suite. Forty-eight percent of CFOs were in their jobs for three or fewer years, and 46.4 percent of COOs.¹⁴

It can certainly be argued that some amount of change in the executive suite is appropriate and essential to promote innovation. Further, as baby boomer leaders begin to retire, the number of executive replacements should also increase naturally. Regardless, no one has suggested that today’s level of churn is healthy, or natural, or in the interest of anyone who has a stake in the process or an interest in the future of the company itself.

The Costs of Leadership Failure

No matter what the cause, the impact of any change in leadership to both the company and the individual are huge. The cost of replacing senior-level executives (excluding CEOs) can run between two and ten times their total compensation, or roughly \$2.7 million on average.¹⁵

At the very top, the costs escalate. When William Perez departed Nike, the company gave him a severance package valued at more than \$14 million, including two years’ salary of \$1.4 million per year and a bonus of at least \$1.76 million.¹⁶ Fortunately for Nike shareholders, his package paled in comparison to the severance packages of some of the more public departures of CEOs like Bob Nardelli from Home Depot (\$210 million),¹⁷ Hank McKinnell from Pfizer (\$123 million), Gary Forsee from Sprint (\$40 million), Carly Fiorino from Hewlett Packard (a mere \$23 million), and

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Richard Grasso's highly controversial package from the New York Stock Exchange (\$188 million).¹⁸ While such extravagant severance packages certainly are occasionally provided, our experience with senior-level executives' severance provisions is less sensational than the extremes already mentioned.¹⁹ Paul Hodgson, senior research associate at The Corporate Library, puts the customary severance that most companies pay a departing CEO equal to approximately three years' total compensation and that for other senior executives at two times their total annual compensation, which is more consistent with our experiences.²⁰ In 2007 the compensation experts at Crenshaw Associates informed us that the average total cash compensation (including bonuses) for CEOs of large-cap corporations (revenues greater than \$4.5 billion) was \$1,650,000—which, using a three-times multiplier, would put their severance at around \$5 million.²¹ It has also been our experience that most CEOs of mid-cap or smaller corporations receive lower severance rates—two years is more common at the middle-size companies and one year's total compensation seems to be the rule at smaller firms. Using average total compensation figures for these groups, their severance payments would be closer to \$1.7 million and \$650,000, respectively.

While not as impressive as the headline “funny money” payments to a handful of executives, severance costs are, nevertheless, a very real, direct cash cost to the company when a CEO failure occurs—and there are more. Other costs may include such expenses as the cost of a retained search to find a replacement or to “benchmark” an internal candidate at 27 to 33 percent of total annual first-year compensation, plus the travel costs to and from interviews for all concerned, as well as for the final candidate's family to visit the new location. Then add to it the possibility of buying out the bonuses, options, and other incentives the new hire would be leaving on the table at his or her current position. As previously noted, severance guarantees made by the candidate's company for purposes of retention must be addressed. Continue by factoring in a six-digit sign-up bonus to help with incidental, up-front expenses, and then add in the cost of both parties' advisory support teams, including contract lawyers, compensation and tax specialists, an assessment team, and increasingly an onboarding adviser. Since it usually takes a newly hired or promoted executive six months to reach breakeven—the point at which new leaders have contributed as much value to their new company as they have taken from it—that initial “sunk cost” needs to be factored in, too.²²

Now throw in all the “exceptional items” for both the departing CEO and the new replacement: the buyback of the house, outplacement services, partial or full-year bonuses (often paid to the outgoing executive and guaranteed to the incoming one), Special Executive Retirement Plan (SERP) costs, relocation expenses (including gross-ups for tax purposes), special medical and life insurance premiums, reimbursement of club memberships and the loss on the sale of the executive's company car, and on, and on, and on. Having tallied

up all these direct costs that are out of pocket and impact the bottom line, take 50 percent, and multiply that amount times three—the approximate cost to replace each of the three executives who will comprise the “involuntary departures” of the 25 percent of executives who will, on average, leave the company after a new CEO is brought in from the outside as his or her “new team” is assembled.²³

But hold on. We are not through yet. There are other, noncash costs that occur when the CEO fails to deliver the expected results. For public companies, one extremely important indirect, but very real, cost comes from the stock market’s reaction to the change. Here is what the research reveals: Researchers at Booz Allen Hamilton recently found that in North America, announcing the replacement of a CEO produces a positive effect (3.8 percentage points better than the average return) when a company has been performing poorly for two years and a negative effect (10.2 percentage points worse than average) when the company has been doing well. More notable than this predictable stock movement is that the “selection of an outsider produces a big downtick in stock price; selection of an insider triggers an uptick.”²⁴

Depending on the condition of the company when the CEO leaves, the “cure could be worse than the disease” insofar as the stock price is concerned—an outside replacement for a company that is not doing well could pose a double-whammy on the stock’s price and market capitalization.

While the stock price will adjust itself over time based on the performance of the company under its new leader, the impact on its volatility can remain a factor for quite some time following a change at the top. In 2003 Rutgers University and the University of Texas, in conjunction with the Federal Reserve Bank, published research reporting that a firm’s stock volatility increased with *any* form of leadership turnover, but a forced departure could trigger an increase in volatility of up to 25 percent, which could last for as long as two years following the event.²⁵

In short, a company’s market capitalization and the stability of its stock are affected when a change is made at the top of a public corporation, and it can take years to fully recover from their effects.

Yet another—and in some ways perhaps the greatest and certainly the most insidious—cost attributable to a failed leadership change comes from its impact on the organization. This is the price of all the opportunities missed because an organization or an operating unit is leaderless, if even for a short while. The loss of momentum and rise of uncertainty that go hand in hand with a change in leadership can, and does, in the estimation of many, cost companies more money, more market share, more loss of reputation, and more customer goodwill than any other single event. Internally, morale suffers, especially among senior managers, who may wonder if theirs will be the next head on the chopping block. A spirit of innovation and willingness

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to take risks can disappear for a while, too, as employees wait to see what's expected of them in the new regime.²⁶ These people-related impacts are not the "soft, people-stuff" that they are sometimes labeled. On the contrary, this "people stuff" is as hard and as real as the currency used to measure organizational success and failure.

Just as the volatility of a company's stock does not settle out immediately upon the appointment of a new leader, neither do the problems afflicting the organization. As a matter of fact there is one particularly debilitating effect that turnover at the top can instill: the loss of trust. Organizational trust, once lost, can take years to restore.

During the course of my career I have observed, experienced, and dealt with the effects of turnover at the top too often to ever underestimate the crippling effect it can have on an organization. Here's the rub: With turnover rates what they are today, *every* newly appointed leader risks being tarred with the same brush of skepticism and distrust even though the company may otherwise be relatively stable. People see what they expect to see.

The Bottom-Line Impact

The financial fallout from leadership failures, then, plays out in many directions: There are direct costs related to the individual's compensation (salary and bonuses) and to the cost of maintaining the person in the job (health insurance, travel, office expense, and the like). There are other, much greater costs that result from errors in judgment, bad strategies, poor execution, opportunities foregone, and the disruption to the organization caused by inconsistencies, lack of direction, and worst of all, loss of trust.

Trying to isolate and measure the financial impacts to the organization of all these factors on a meaningful basis is a challenging exercise because there are so many moving parts, some of which are intangible. However, Dr. Bradford Smart, author of *Topgrading*, has given us a framework for estimating the overall financial effects of failure among CEOs based on research findings from work done by Chris Mursau.²⁷ Through a series of interviews with executives (half of whom were division presidents or higher) about their experiences with twenty-six "mis-hires," the amounts these poorly performing "B" and "C" managers (whose salaries averaged slightly more than \$168,000 per year when the research was conducted in 1998) cost their companies during their first eighteen months in the job were identified. We conservatively assumed that the impact of the CEO who failed after eighteen months in the job (which is 40 percent of the cases, as you will recall!) would be, proportionately, no less than that of the lower-level executives as reported by Smart. Clearly, the case can be made as to why these numbers should be *greater* given the impact the CEO has versus a middle-level manager. Our

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Table 1.1
Estimated Costs of CEO Failures at 18 Months in Job (\$000)

No.	Item	Large-Cap Companies (\$4.5B and up)	Mid-Cap Companies (\$1B to \$4.5B)	Small-Cap Companies (\$300M to \$1B)
1	Average Annual Cash Comp ^a (2007)	1,650	860	640
2	Cost of Hiring ^b	825	430	320
3	Total Cash Comp ^c	2,475	1,290	960
4	Cost of Maintaining ^d Person in the Job	455	230	170
5	Severance ^e	4,950	1,720	640
6	Mistakes, Failures, ^f Wasted and Missed Business Opportunities	32,645	13,770	7,840
7	Cost of Disruption ^g	16,320	6,890	3,920
8	Total Cost of Failure	57,670	24,330	13,850
9	Value of Contribution ^h	5,170	2,230	1,250
10	Net Cost of Failure	52,500	22,100	12,600

^a Courtesy of Capital IQ, a division of Standard & Poor's. See <https://www.capitaliq.com>.

^b Crenshaw assumes that recruiter's fees (33 percent) and other hiring costs total 50 percent of first year's total compensation.

^c This is calculated as 1½ times the average annual cash compensation to cover the first 18 months.

^d Smart, *Topgrading*. The author reports that the percentage of total compensation spent on maintaining a senior executive is 20 percent.

^e Paul Hodgson at the Corporate Library has collected data that shows severance for executives three times their average annual compensation; this has been reduced to two times average annual compensation at mid-cap firms, and one time at small cap firms based on experience at Crenshaw Associates.

^f Smart, *Topgrading*. The author determined that these costs represent 80 percent of the total costs of a mis-hire.

^g Crenshaw Associates assumes that, at the top, disruption is very costly and equal to at least 50 percent of the failures and mistakes (totaled in the preceding line).

^h Smart, *Topgrading*. The author found that positive contributions made during the first 18 months equal 9 percent of the total costs.

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estimates are shown in Table 1.1. Where we made changes to the ratios in Dr. Smart's findings we have provided notes.²⁸

As shown in Table 1.1, the cost of having the wrong CEO at the helm, even for just eighteen months, can range between \$12.6 million and \$52.5

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million depending on the size of the corporation. This analysis also reveals two other relevant points:

1. **Smaller companies are hurt significantly more by selecting the wrong CEO.** If we assume that the profit-margin percentages are the same regardless of the size of the company, then the impact of having selected the wrong CEO to lead the business is greater on the small-cap companies than the bigger ones, even though the absolute dollar impact is roughly five times greater for the large-cap firms. Assuming that the profit margin for mid-size and small-cap companies is 6.0 percent as it is for the 487 publicly traded U.S. corporations with revenues in excess of \$4.5 billion that constitute the large-cap group, then the estimated direct (cash) costs of CEO failures as a percent of average profits goes from .3 percent for large-cap companies, to 9.6 percent for mid-cap firms, to a whopping 23.2 percent for small-caps.²⁹ Needless to say, the effect of the wrong leader on a smaller entity can be devastating, as has been seen time and again over the years.
2. **The impact on the U.S. economy is nearly \$14 billion per year.** Recognizing that the turnover rate of CEOs has plateaued over the past three years at an average of 1,385 per year, the total cost of CEO failures in terms of cash, inefficiencies, and opportunities foregone is calculated to be \$13.8 billion, assuming the failures are distributed on a quid pro quo basis relative to the number of companies in each of the three segments. And this number does *not* include the lost shareholder value caused by the mistakes, failed strategies, organizational upheaval, and increased stock volatility that comes from having selected the wrong leader—all of which add up to a very target-rich environment for anyone looking to find disciplined ways to put an end to such waste.

The Human Cost

The effects of a failed leadership transition are not limited to just the company, its shareholders, and its employees. Its impact on the lives of the people who are affected should not be ignored. While the stakes and costs of failed leadership transitions can have a big impact on corporations, companies do not have feelings; they do not grieve; they do not have to fight the way the affected leader does to continue on. Even though their departure may make them very wealthy overnight (some excessively so!), rarely is that much solace. The loss of status, power, and reputation, not to mention the damage done to their egos and self-esteem, is often so great that some never recover from the experience. Too frequently the battle back to their former

“heroic status” demands so much time, courage, and determined fortitude that the former leader does not really make a comeback.³⁰

Having now been in the senior executive outplacement business for over seven years, I have seen the impact that career setbacks can have on the self-confidence of even some of the strongest personalities. As one client articulated it to me, “Even though I’ve been going to my club almost once a week for the past ten years, all of a sudden it feels like I don’t belong there—that I’m in arrears in my dues or something. Guys who have been friends for years seem to avoid talking with me and shun my presence. Maybe it’s me, but I just don’t feel like I’m a full-fledged member anymore.”

As devastating as leadership failures can be for the executives involved, theirs is by no means the greatest of the human costs. Hundreds, thousands, and even tens of thousands of other people can be significantly impacted by a single leadership failure and often in proportionately far greater ways. And the failure doesn’t have to be of a cataclysmic nature to exact a large toll on others. To return a company to solid footing, jobs are often reduced and people furloughed as a part of needed cost-cutting or organizational restructuring within the firm. In a ripple effect, jobs at suppliers and in community support functions can then also be affected. Those whose jobs remain intact often find their pay reduced through lower year-end profit-sharing bonuses, lower incentive compensation payouts, reduced corporate participation in matching 401K contributions, and fewer overtime opportunities for hourly people. Opportunities for promotion and career advancements can be lost for people who worked hard for them, prompting them to significantly re-think and adjust their career plans. This can frequently lead them to make lifestyle changes, accept higher-risk jobs, relocate, take second jobs, moonlight, delay retirement, or force the unplanned return to the workforce of a non-working spouse—all of which take a huge toll on the individuals and their families.

Consequently, the effect of today’s high leadership turnover is borne widely and in very real, very painful ways. Sadly, nobody escapes a failed leadership assignment unscathed. Companies *and* individuals alike pay huge prices whenever a failure occurs. So why are there so many of them nowadays?

The Rules Have Changed and So Has the Game

One of the saddest aspects of these failures is that they may have very little to do with the individuals’ competence. During the past ten years the performance climate for business leaders has undergone significant changes in almost every possible dimension. It is no longer good enough to just “beat last year’s top- and bottom-line numbers” to declare the year a victory. It’s not

even good enough to beat the same quarter's numbers every quarter throughout the year. Now, executives must beat those benchmarks plus a whole set of other expectations to be considered as having had a winning year.

The facts are that today's leaders are not only expected to do more with less and faster than ever before, they are now supposed to involve more people, produce more reports, and even provide more input and oversight into other areas as well. As one of my coaching clients recently put it in a moment of frustration, "It's not like I'm hiding anything or doing anything I shouldn't be doing. It's just that there aren't enough hours in the day to read all my e-mails and produce enough PowerPoint presentations to satisfy everyone's desire for more information, more scrutiny, more assurances, more, more, more. It's like the world has forgotten that, inherently, business is risky, and *no* amount of inspection is ever going to change that fact!"

Although reams could be written about the many changes that have impacted the nature of the leadership climate over the past decade, suffice it to say that business leaders today are faced with the challenge of having to manage a greater order of complexity in a more transparent manner and to deliver more finite results in more compressed periods of time than has any previous generation of leaders.

How Much More Perfect Can We Get?

Given this environment, the chances are greater than ever before that even the most highly trained, experienced, and capable leaders will fail to measure up to the expectations held for them at the time they are hired. This is undoubtedly why we have seen so many books and articles on the subject of leadership in the past decade. Trying to refine and improve our insights into what makes a successful leader is an understandable response. However, the lack of impact of these studies on the failure rates indicates that these analyses have probably not helped to any significant degree.

At the same time that our knowledge of what qualities a successful leader should possess has grown, there has also been an increased emphasis in defining the competencies of the candidates. Historically, the hiring process used by most companies has been focused on finding the best leader for the position based on a position description—a profile of what the ideal candidate should "look like" in terms of specific "must possess" and "desirable" experiences, education, and background. More and more frequently a specific set of competencies required of the individual is also a part of the hiring specifications. The underlying belief on which the typical hiring process is built is that, "if you find the right person, he or she will know how to get the job done."

To help ensure they have found the "right" person, companies today put candidates through extensive interviews, in-depth background checks,

and even psychological and behavioral assessments, which we will discuss in later chapters. In short, what has happened is that our understanding of what it takes to be a leader has been expanded greatly, and we have employed that knowledge to scrutinize candidates more closely. Even so, failure rates have increased significantly. Something is still chronically wrong.

A More “Holistic” Approach to Hiring

We have done little, however, to change how we view the job the new leader will fill and the context in which that job must be carried out. While the world has changed—the risks and costs and likelihood of leadership failures have changed, and the expectations, timetables, and the complexities of the jobs have changed—beyond looking more closely at the candidate, the Traditional Selection Process has not. As always this process still focuses on selecting the right “peg” with little, if any, effort made to understand the specific shape and nature of the “hole” into which the peg is supposed to fit.

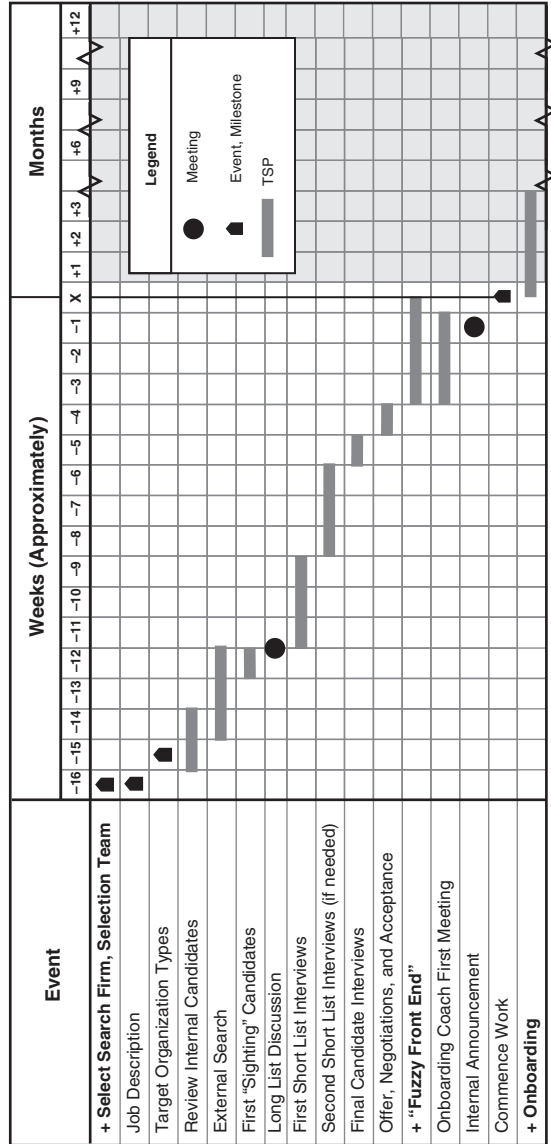
Given the continuing failure rates of scores of bright, motivated, and, yes, competent, leaders, it is time for the paradigm to shift. It is time that companies and candidates put as much of the same critical and data-driven effort into understanding the shape of the hole as they do the shape of the peg, realizing that just because the Bill Perez peg fit well with the S.C. Johnson hole previously, it was not going to automatically fit into the Nike hole no matter how patiently or how hard it was pushed. As we have seen, trying to jam the wrong peg into the wrong hole has costly and painful consequences for one and all.

Find a Need and Meet It

Figure 1.2 depicts what we shall call throughout this book the “Traditional Selection Process” that is typically in use today.³¹ It closely resembles the selection process that has been in use since the middle of the twentieth century. During the intervening decades many of the steps that make up the Traditional Selection Process have undergone refinement and change: The types of interviews that are used are vastly different from those used in the past; in addition, three steps have been added (shown in bold). But, of these, only onboarding has significantly changed the original model, and that regrettably occurs *after* the leader has already been selected.

If you look closely at the Traditional Selection Process Gantt Chart (Figure 1.2), something may strike you: Other than the second step, every one in the process, including the new onboarding one, is focused on the individual. The process has been designed to identify the right candidate for the situation. But only one of the eleven steps even attempts to analyze the

FIGURE 1.2 Traditional Selection Process



realities of the business situation that will define what the right candidate will have to accomplish.

Through my years as a journeyman CEO, I have seen a number of job specifications for various CEO positions; as the head of a career transition and outplacement company for senior executives, I have seen even more job specs during the past seven years. One of my clearest conclusions is that, if you took the company name off the top of the page, you would not be able to tell one from another. There are several reasons that this is largely true: For one, the people who write the position specifications have rarely ever actually done the job, so how would they know what it takes to do it well? Second, in this politically correct world, there is a tendency to try to put specifications in for everything anyone else has ever included, “just to be on the safe side.” A third reason is that the search executives who are involved in the process will often want to help the company by broadening the specs to ensure they can cast a net wide enough to land someone for the job who might not otherwise be considered.

However, the two most compelling reasons the position specs usually look the same for the top jobs are:

1. The people who know the most about what needs to be done by the new leader to deliver the desired results—namely the direct reports of the new leader—are rarely asked. Rarer still are situations in which they are asked for their input in ways that will prompt anything other than a safe, politically correct response. In other words there is very little rigor involved in gathering data from this valuable source of highly relevant information.
2. Mistakenly the deliverables in the specifications are based on the experiences and perceptions of the people writing them and are focused on outcomes, not on hard facts expressed in terms of the specific actions required to produce these outcomes in a particular situation. Both of these points get companies into trouble when hiring new leaders.

A case in point (and just in time), follows.

Real Vs. Perceived Corporate Needs

A few years ago, my company was brought in on a consulting assignment by a NYSE-traded corporation while the search for a new CEO was underway. According to the position specifications developed by the head of HR in collaboration with the executive recruiter, the lead director, and the head of the board’s search committee, one of the key attributes that the new CEO would have to possess was “strong experience dealing with sales organizations and their restructuring.” The reason for this spec was that the board suspected systemic problems existed in the sales organization.

(continued)

When we looked at the company's sales performance for the previous three years, their concern seemed quite legitimate and their conclusion understandable. Sales had been basically flat for three years while previously the same field sales organization had delivered consistent growth above the industry average. This was no small feat since they were the dominant player in their industry. Clearly something had to be done to get sales growing again. Based on the perception of the board, that would entail restructuring and replacing a lot of people. They wanted to be sure that their new CEO was no stranger to this kind of work.

When we conducted our interviews with the people closest to the work, however, a very different picture began to emerge. As it turned out, the sales force had the enviable reputation of being the best trained and most disciplined of any in the industry, and the company was highly respected for its service delivery. Furthermore, every one of their competitors' top sales executives had, at one time or another, come from my client's company.

At first the pieces did not fit, but as we kept digging, we eventually got to the crux of the problem. In three of the preceding four years the former CEO had insisted on changing the sales compensation plan in an attempt to achieve alignment with that year's management directives! One year, the sales goals were based on obtaining new dealers; the next, they were based on selling new products; in the third, the incentives were intended to stimulate customer retention and increased sales through existing accounts. Since these changes were developed at the initiative of the CEO, it was self-defeating for him to go to the board and admit that, "Oops, I shouldn't have been trying to drive short-term results in a long-lead time business." Neither was the head of HR inclined to point at the numerous changes to the comp plans since he was their architect; he just went along with the board's view of the problem while developing the position specs for the new CEO. As a result the board focused on other reasons for the poor sales performance. Meanwhile, with all the changes thrown at them, the sales team did not know whether they were on foot or on horseback.

Fortunately, as a result of our findings, we were able to eliminate the requirement that the top candidate possess a heavy sales background, allowing another candidate—one who had leadership traits and background experiences that were more aligned with the true needs of the company—to get the nod. Over time, he proved to be the right person to make the changes that were really needed. These included stabilizing the sales compensation plans. By focusing on the real needs instead of the perceived needs, less time was required to reenergize the existing sales team than if restructuring the field sales organization had been pursued. A disaster had been averted.

This is one of many experiences that support our contention that the current hiring process often fails to account for the real needs of the situation. None of the steps incorporate rigorous “fact-finding” or bona fide research to verify what things *really* need to change and which changes should come first. Nor, as in the case with my client described previously, does the Traditional Selection Process identify those things that should be left alone.

Culture—A Matter of Fitting In

Now if you look back at Figure 1.2, there is something else that should be noted—something that is missing entirely. No place in this “peg-oriented” process is there a step to identify anything about the culture of the company overall, or of the culture of the team the new hire is going to lead. Just as importantly, nowhere in this process is there a place to identify anything about the culture of the team on which the new leader is going to be a member—the boss’s team.

The Nike story we told earlier helps explain the need to focus on the missing steps in the Traditional Selection Process. As it illustrates, most leaders do not fail because they cannot do the job. They fail because the way they go about it is simply not compatible with the culture of one or more of the prevailing groups they have joined. In other words, leaders do not fail just because of *what* they do; their problems usually stem as much from *how* they do it. Yet nowhere in the Traditional Selection Process is there any step to specify the kind of culture(s) through which the proverbial “right person” is supposed to work effectively. Without that knowledge, how are hirers supposed to know what characteristics to look for that are necessary for someone to fit in here?

The day after William Perez “resigned,” the *New York Times* ran a story under the headline, “Another Outsider Falls Casualty to Nike’s Insider Culture.” It identified several key points about Nike’s culture that included: New hires are expected to operate within strict “lines of orthodoxy”; there were unclear lines of authority and responsibility at the top; there were entrenched pockets of political resistance on the team Perez inherited; certain changes were viewed as being “off-limits”; and that outsiders have had difficulty transitioning successfully into the company.³²

So, if this information about the culture of the Nike organization was available for publication the day *after* Mr. Perez got the boot, wasn’t it probably available the day *before* he left, too? Then, how about the day thirteen months earlier before he *arrived*? Based upon my experiences over these past years, I am quite certain that every bit of this information about the Nike culture that so curtailed Bill Perez’s effectiveness was completely available *before* he accepted the offer. But no one seems to make the effort to look for them.

Had Mr. Perez had access to the information about Nike's culture prior to deciding to join them, he would have had two clear-cut options to deal with the situation: He could have elected to *refuse* the position if the problems were more than he wanted to tackle, or he could have elected to *change* the way he went about doing things. When faced with a new set of facts, leaders consistently demonstrate a remarkable ability to adapt to the most demanding of situations and, in effect, modify the shape of their own "peg-ness" to better fit into the "hole" at hand. As we shall see, however, this leadership malleability works only up to a point; it is more likely to affect behaviors associated with style than those connected to the leader's values and basic business beliefs.

The New Leadership Selection Strategy

This is what *The Right Leader* is all about—using the time either before a search begins or concurrent with it to identify and analyze the missing factors that the candidate will have to address: first, the people, processes, structure, strategy, and capital (the true "needs") of the company; and second, the nature of the cultures in which he or she will have to work.

The Leadership Selection Process this book describes is truly revolutionary. It adds entirely new steps to the Traditional Process. It changes the paradigm so that the capabilities of the selected individual not only match the needs of the company, but it also ensures that his or her character fits with the culture of the company. Without increasing the time that selection takes, the Accelerated Leader Selection Process provides the company and the hiree with two vital elements:

1. **A true understanding of what needs to be done to be successful.** What needs to be done should have a big impact on who is selected to do it. Unfortunately, without sufficient rigor, the needs that make it into the hiring specification for most leadership positions tend to be those based on perceptions and not facts. It is time to incorporate those same data-driven principles into the hiring process that have worked to reduce costs and improve quality in other disciplines. Getting to the real needs entails conducting research and building the hiring process on hard data instead of on perceptions, opinions, and politically correct generalizations. The expression, "You can't manage what you can't measure," which serves as the philosophic foundation of Six Sigma, "Lean," and Continuous Improvement processes is just as applicable to the hiring process as to any other area of the business.
2. **A clearer understanding of what it means for an executive to "fit" the organization and the importance of obtaining proper fit.** The second change is the addition of an element that heretofore has been

absent—a methodology that bursts the bubble surrounding the term “culture” and helps to define, describe, measure, and clarify exactly what and how a *particular* culture can affect a *particular* leader’s success or failure in a *particular* work situation. It is time that the shape of the “hole”—the cultures of the corporation and of the work teams of which the new “peg” will be a member—are measured and analytically defined. It is time to treat culture like any other factor critical to the company’s success—to measure it to manage it.

This is not to say that the current hiring model should be abandoned entirely. On the contrary, all the excellent work that has gone in to refining the existing steps should remain intact. But it is time to incorporate further, purposeful improvements to what is there while adding what is missing from the process into it. Only then will the process be responsive to the realities of today’s work environment and reduce the risks and extraordinary costs of failed leadership.

The good news for those who must lead the hiring process and are under the gun to “fill the slot yesterday” is that the work associated with these changes to the hiring process can be, and often *should* be, conducted simultaneously with the existing traditional steps in the selection process so no incremental time is required to complete it. Another piece of good news is that these changes are best performed by independent consultants so the burden of work does not land on some already overworked individual within the company who may be ill-prepared to handle the task. More importantly, though, the work needs to be done by an outsider because nobody who is a part of a given culture can detach themselves from it sufficiently to examine and describe it objectively. That, as we shall see, is a very real part of the nature of cultures. Finally it should be clear that there is a huge cost-benefit justification to implementing these changes instead of the simple rationale that “it’s the right thing to do.” Even so, for many, many good reasons, selecting the *right* leader *is* the right thing to do.

Takeaways

Here’s a quick recap of the current state of the executive selection process:

- The failure rate of CEOs (and other senior leaders) today seems to have plateaued at record highs—more than 50 percent greater than just a few years ago. Performance-related terminations of CEOs are more than three times what they were ten years ago. The costs of a failed leadership assignment are huge and go well beyond the direct cash costs incurred by companies. Even without monetizing the costs of lost market cap and

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the impact of increased stock volatility, the costs of today's turnover at the top after just eighteen months in the job ranges between \$12.6 and \$52.5 million depending on the size of the company.

- Smaller companies are hurt more than large ones primarily because they have less room for error due to their size, relative to the direct costs associated with CEO failures.
- In total the cost to the U.S. economy for selecting the wrong leaders is approximately \$14 billion per year in cash, inefficiencies, and opportunities foregone.
- Leadership failures have far-reaching implications for many, many people, well beyond those who are directly affected. Sadly, no one escapes a failed leadership transition unscathed.
- The world has changed, and so have the risks, costs, and likelihood of leadership failures. Changes have also occurred in the expectations for deliverables, timetables for achievement, and the complexities associated with virtually every aspect of leaders' jobs. The Traditional Selection Process used for selecting leaders has not, however, changed significantly to keep pace.
- The Traditional Selection Process focuses on the right "peg" with little, if anything, done to rigorously comprehend the specific shape and nature of the "hole" into which the peg is supposed to fit—the true needs of the company and its various cultures into which the right leader will have to fit to deliver the expected results.
- The Traditional Selection Process should not be abandoned entirely, but it is time to make some needed improvements and to incorporate what is missing into it.