The Five Levels of CEO Work and Capability

By Mark Van Clieaf

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According to the *Harvard Business Review*, "Two out of every five new CEOs fails in their first 18 months." Given the resultant turmoil and attendant loss of managerial focus on the business, as well as the cost of severing the outgoing CEO and, sometimes, attracting the new one, this is no small problem. CEO replacements made in such a short time period are almost always the result of business issues that have already cost the shareholders dearly. So why is such a critical board accountability being done so poorly and so frequently?

Our best practices research on succession planning addresses a number of flaws in the typical CEO selection and succession-planning process as well as offers an effective framework—*levels of work* and *levels of executive capability*—that we believe dramatically increases the probability of having the right CEO, with the right capability, in place at the right time.

Its starts with the fact that not all CEO roles are created equal. There are actually five CEO levels of accountability—levels of work—and independent board members must choose the correct level based on the business strategy and acceptable level of risk for shareholders' capital. Many succession and CEO selection mistakes result from a failure to understand these five levels and their implications for matching CEO talents required by the business to sustain itself and create longer-term value.

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One all-too-common problem is that the board does not actively engage in CEO succession planning, deferring to the current CEO both on developing senior level talent and filling the jobs most likely to produce a replacement CEO, as well as to the CEO's specific choice of a successor. Boards should be clear that the CEO succession planning process should be owned by independent directors. Other fundamental problems with CEO succession planning processes take a variety of forms, but has a common underlying flaw: they treat succession planning as an episodic event only loosely related to the underlying business strategy of the company.

Manifestations of these issues include:

- Failing to define the level of accountability and value-add required of the CEO role given the 3-, 5- and 7-year scenario plans for business strategy and related organization design
- Developing and applying generic competency models for leadership assessment that don't take into account the specific leadership capabilities needed to operate at the level of work complexity indicated by the strategic and investment plan
- Confusing the replacement planning process (which identifies and utilizes talent that is ready now) with succession planning (which identifies both ready-now talent as well as talent expected to be ready in 3- ,5- and 7-years based on specific development plans designed to meet the requirements of the chosen business and organizational strategy)
- Lacking a robust talent assessment process to evaluate both the current performance, potential performance and the leadership accomplishment track record of executive talent

CEO succession planning should be an ongoing board accountability, in which the board periodically reviews the level of strategic work required by the company to achieve its longer term goals, and the level of CEO capability required to accomplish that level of work. The Board should assess the level of current and future capability of the CEO and direct reports to the CEO to identify talent gaps and ready-now candidates, candidates ready in 3 to 5 years, and 3 to 5 year development plans for key team members as possible CEO successors.

An accompanying roll-up talent review process should be owned by the CEO in which he or she presents to the board on performance of team members 2 to 4 levels below the CEO and the long term potential of these team members. These processes help the Board and CEO determine the gap between the 3 to 5 year business strategy and the talent pipeline required to deliver the strategic business plan as well as sustain the enterprise.

Accomplishing these streams of work and ensuring that they are integrated is no easy task, but the *levels of work* and *levels of executive capability* framework we have developed makes defining CEO roles and the requisite competencies easier. This framework also defines the building blocks of executive development planning for general management work at increasing jumps of scope, scale and complexity. These levels are based on principles of complexity and how they relate to innovation and value creation, *not* the size of the company.

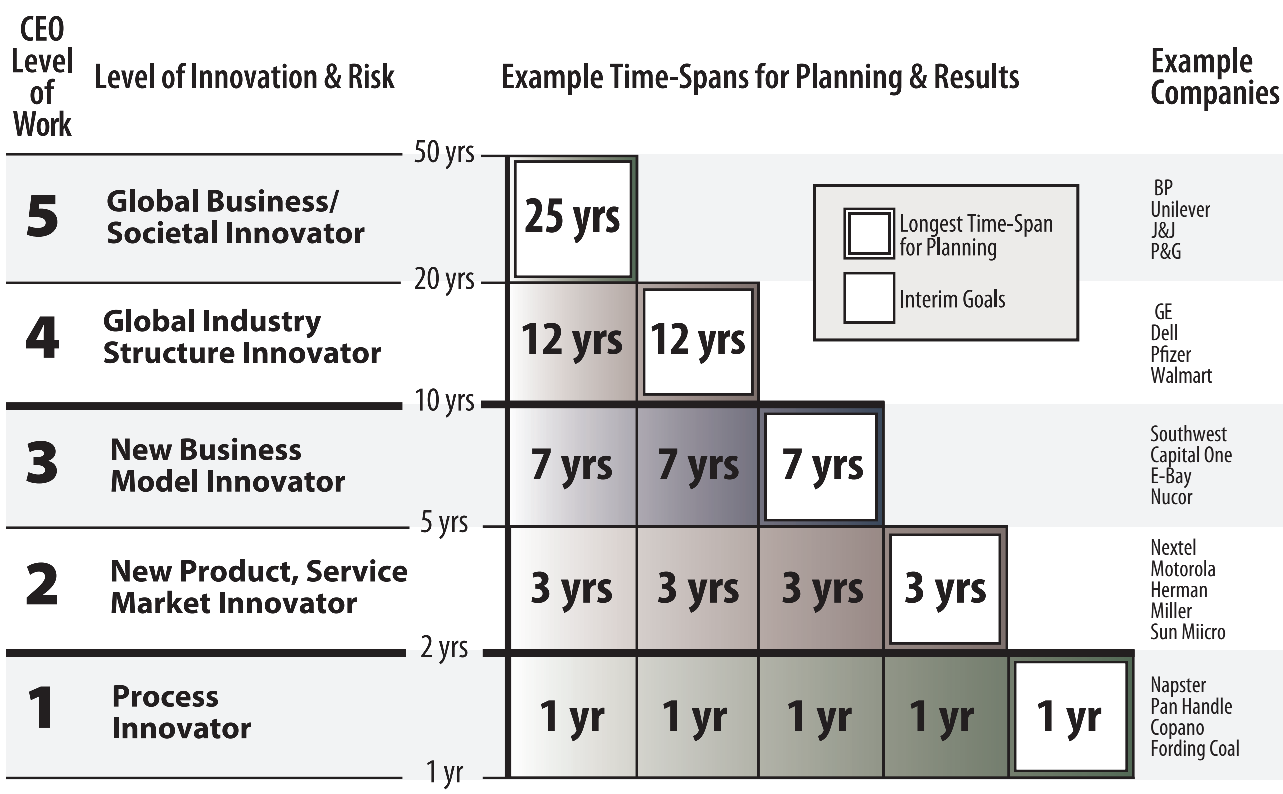
The five levels of CEO work provide an empirically proven set of tools, processes and principles to define work complexity, accountability, and decision-making authority and ensures that value is being added at each *level of work* for customers, shareholders, and possibly global society.

Five levels of CEO work and capability

The *level of work* framework uses six factors to determine which of the five levels of work and innovation is required by an organization to sustain itself as a viable system. Four of these factors are the level of innovation complexity; the planning horizon; the level of complexity of assets/capital managed; and the level of complexity of stakeholder groups to be managed given the number of different businesses and countries in which the enterprise may operate. (See chart)

The *level of executive capability* identifies the level-specific competencies that match each requisite level of work. Each jump in level is discontinuous both in work complexity, conceptual and strategic thinking, and executive time-horizon. The level of executive capability provides a robust executive assessment model to determine if a candidate can operate at the level of work identified for the company. It is also a valuable tool in the talent development process, as the competencies at each distinctive *level of capability* are predictors of:

- ***Potential*** to get to the next level
- ***Performance*** at each requisite level
- ***Derailment***, if one level is not mastered before the executive is promoted to the next level of work complexity.



Based on 400 + MVC Interviews at the Global CEO, Group President, President, and VP/General Manager Levels

> "Based on this organizational and leadership analysis, the board determined that it needed a new CEO—despite the fact that the current CEO had performed admirably."

It is critical that boards select a CEO capable of working at the chosen level of work because the work complexity to be accomplished cannot be above the CEO's level of executive capability. In other words, if the board determines that the corporation requires a CEO four level of work—the global industry innovator role (possibly an HP or Disney), but selects a CEO only capable of operating effectively at a CEO two level of executive capability—the new product/service innovator—then the selected CEO simply does not have the conceptual, strategic and other skills required to operate at the level the board believes the company needs to add value to the enterprise, including creating positive return on invested capital.

Also, if the board selects a CEO only capable of a CEO two level of work, and the organization already needs a CEO three level of work or higher, this will in most cases create a "jam up," where the next two levels in the management team will feel the CEO is not adding much value, failing to delegate properly and spending too much time crowding out their direct reports. The result is a talent pipeline which begins to leave the company in frustration.

Ultimately, business strategy, organizational structure, and enterprise performance will tend to follow the CEO level of executive capability regardless of the board's vision and how well the CEO role is defined. Defining the CEO level of work and matching CEO level of capability at too-low a level will put the long-term viability and sustainability of the enterprise and its shareholders capital at risk.

Case study in CEO succession planning

Once boards step back and define the level of work required by the corporation, and thus the CEO level of accountability, the tasks of determining the strategic time-frame for planning and the level of capability required by—and appropriate compensation for—the CEO becomes much clearer and easier to accomplish. A real-life case study which we teach at the Ivey School of Business will illustrate this.

The board of a $1 billion technology company with poor financial results, responding to pressure from institutional shareholders, removed the CEO and replaced him with the best candidate from the current executive team. Within a year, the newly promoted CEO asked the board to triple his compensation based on industry peer group compensation levels.

We facilitated a discussion of independent board members using our *level of work* framework. The independent board members agreed that the company needed a CEO role held accountable at CEO level three—the business model innovator—because the enterprise required a new business model given changing technologies, aggressive new competitors, emerging new markets and the fact the company had not returned a profit greater than its cost of capital in five years.

The independent directors then assessed the current CEO's level of capability, relative to the skills/capabilities required for the newly defined CEO level of work. The leadership capabilities required for the business model innovator role included:

- conceptualizing and implementing a new business strategy and economic model enabling the company to create a positive return on invested capital
- planning out 3-, 5- and 7-years and setting accountable milestones for company transformation as the industry changed with new technologies and emerging new markets
- continuing to meet short-term revenue and profit growth targets while managing a change process requiring transformation of the company's structure, technologies, processes, and profit drivers

Each independent director used an instrument which rated the current CEO on twelve key skill dimensions of the business model innovator. After analyzing the rating results, it was apparent that the board believed that the current CEO (who had done a good job) was a great operator—CEO level one—but not capable of performing effectively at the business model innovator level.

Finally, the board discussed the $6.5 million total direct compensation requested by the current CEO compared to the CEO's current $1.6 million total compensation package, and found:

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> "An interim's talents and goals aren't normally aligned with a long-term commitment to an organization."

identified as the successor, but was viewed as being 18 months away from being ready to assume the position.

The interim executive shadowed the CEO-designate, helping him to develop his confidence in front of financial analysts and key stakeholders for 14 months before exiting in a seamless transition. The key to the success of this assignment was that no one outside the business was aware that the CEO-designate was being mentored and he was able to learn in a decompressed environment.

According to William Werdenberg, an interim executive based in Texas who has served CEO assignments with businesses like Gresham Computing, "First and foremost you are there for the board and what is in the best interest of the company. Many businesses can get blurred vision during changing times and an interim will bring renewed focus to the organization, providing objective and honest input into their current business strategy."

It is quite common that a successful interim CEO will be offered the permanent role while on assignment, but depending on the specific scenario, this is rarely appropriate. Werdenberg agrees, "An interim's talents and goals aren't normally aligned with a long-term commitment to an organization. My role is to stabilize the business while the board finds my replacement. Once the board has made a decision on the new CEO, my role turns to that of mentor and within two to six months, depending on the situation, I should no longer be there."

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- There was a gap of three levels of work between the level of executive capability of the current CEO and the level of work of most of the benchmarked peer group CEO roles.
- There was a gap of two levels of work between the level of executive capability of the current CEO and the level of work required by the company

Stated differently, if the board determined the CEO's appropriate compensation by the traditional approach of benchmarking the competition, they would have agreed to pay the current CEO four- to eight times more than the level of compensation merited given his personal level of leadership capability.

Mostly importantly, the board not only could not justify the compensation demands, it needed a CEO role that could be held accountable at a higher level of work, and a new CEO capable of operating at the equivalent level of executive capability. Based on this organizational and leadership analysis, the board determined that it needed a new CEO—despite the fact that the current CEO had performed admirably in getting the corporation to its current point and had produced improved short-term financial results.

The board started a nine-month search for a new CEO.

Mark Van Clieaf is managing director of MVC Associates International. His background includes a number of years in the business strategy and executive search consulting practices at Price Waterhouse. He is a guest lecturer on corporate governance at the Ivey School of Business; was a member of the NACD Blue Ribbon Commission on CEO Succession Planning; a founding member of the Executive Selection Research Advisory Board, Center for Creative Leadership; and Past President of the Strategic Leadership Forum. The author can be reached at mark@mvcinternational.com

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- Does this person inspire people to follow and trust them and do they really listen to others in a respectful way?
- Does this leader share information, resources, praise and credit?

It is important to note that people who interview well for CEO positions may not be the right candidate. Often, someone with great charisma also has a big ego, and that does not necessarily make a great CEO. An effective leader gets things done through other people. They have to be able to get everybody focused on their vision of the company's strategic direction and to galvanize the whole organization for a positive change.

Betsy S. Atkins is CEO of Baja Ventures, an early stage venture capital fund focused on the telecommunications industry. Previously she was CEO of N.C.I. Inc., a nutraceutical food company, and was a co-founder, in 1989, of Ascend Communications Corp., which was acquired by Lucent Technologies Inc. for $23 billion in 1999. She currently serves as a director of Chico's, Polycom Inc. and UTStarcom.