CEO SELECTION IN FINANCIAL SERVICES

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Massey Henry

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PREFACE

In this article, we will examine the following:

- Recent research on CEO longevity and the importance of implementing well-structured CEO succession planning and selection processes by the board
- Considerations for selecting an internal CEO candidate versus exploring the external market
- Our firm's recommended step-by-step approach to ensuring an effective and successful CEO selection process

As with all Massey Henry thought leadership, this work is independent, reflects our own views, and has not been commissioned by any business, government, or other institution.

Massey Henry is a leading Canadian executive search and advisory firm, offering solutions to today’s complex executive recruitment challenges, with a focus on the financial services sector.

FROM OUR NETWORK

CEO selection and succession planning in financial services requires boards to develop a well-structured and forward-thinking approach. Working with Michael Henry and his team, I've seen first-hand the benefits of adopting a long-term strategic planning process when identifying and onboarding key executive leaders.

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INTRODUCTION

Boards—especially within a financial services environment—play a critical role in providing direction on organizational strategy and performance while operating with shareholders, consumers, and key stakeholders top of mind.

While the scope and oversight of boards have grown exponentially in recent years, there are two critical responsibilities that are especially pertinent for Directors. These include approving a sound strategic plan for the organization, and, just as important, ensuring an **effective CEO succession and selection process.**

Recent data regarding CEO tenure suggests the challenges are significant. For example, a study published in CEO Magazine indicated that average CEO tenure has declined from 8.5 years in 2003 to 3.7 years in 2020.

Studies by PwC and the Conference Board have identified various factors that impact CEO tenure, including the complexity of the organizational operating environment due to ESG adoption, COVID considerations, rapid technology transfer, and changing global trade dynamics.

Given this context, it will be important for boards to stay ahead of such challenges and develop a well-structured CEO selection process, combined with an effective internal CEO candidate development and succession strategy. The remainder of this article will focus on Massey Henry's recommended approach to ensuring an effective CEO selection process.

STUDIES SAY...

- **Average CEO tenure has declined** from 8.5 years in 2003 to 3.7 years in 2020
- **Several key factors impact CEO tenure**, including the complexity of the organizational operating environment due to ESG adoption, COVID considerations, rapid technology transfer, and changing global trade dynamics

WHAT WE WILL COVER...

Internal vs. External CEO Candidates

Establishing the CEO Search Mandate

Determining the CEO Selection Committee

Stakeholder Consultations & Communications

Selecting an Executive Search Firm

CEO Compensation Review

Assessment & Onboarding

INTERNAL VS. EXTERNAL CANDIDATES

The challenge of identifying and onboarding CEO hires while factoring in internal and external candidate considerations has been well documented. When organizations do not readily possess the internal talent needed for such a role, there is no other option but to look externally.

Often, the absence of competent or "ready" internal candidates is directly related to the efforts made by an organization in developing its senior executives internally, or towards sourcing potential CEO successors three to five years in advance of a CEO's decision to retire.

Research suggests that while internal candidates tend to have longer tenure and more effective leadership transition experiences, organizations often lack suitable successors within the organization. **In many cases, a vastly different competency set is required for a new CEO in tandem with market and operational considerations,** which internal candidates may not possess. For these reasons, research has shown that organizations select external candidates to replace incumbent CEOs more than 60% of time.

Whether an internal or external candidate is ultimately selected, there are many important decisions that the Board can make to mitigate risks around performance and/or tenure.

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Below, we discuss the five key areas that can make a significant difference in the outcome of a CEO selection process.

1) Establish the CEO search mandate

The board plays an important role in defining the objectives, guidelines, and process for CEO selection.

The CEO mandate needs to be well crafted, and decisions must be made to ensure sound communication with key stakeholders regarding the recruitment process and/or the selection of an executive search firm.

Determining a consensus around the required experience, expertise, functional skills, and behavioral attributes of the future CEO will be especially important. Whether or not a formal CEO succession program is in place, the full board should be engaged in identifying the ideal CEO candidate profile.

This discussion should be informed by the existing three to five year strategic plan, as well as the organization's performance and competitive landscape. Given the importance of strategy within a board's duties, all relevant information should be transparent.

While these discussions typically involve the incumbent CEO in most organizations, the board should also consider the candidate profile independent of the current leader. Independent reflection will enable the board to openly discuss any expertise, experience, or leadership style considerations required for the future CEO.

2) Determine the CEO Selection Committee

After establishing the ideal candidate profile for the next CEO, the board will need to determine the members of the CEO selection committee responsible for overseeing the recruitment process.

Whether a standing selection committee exists or not, the board Chair should carefully review the composition of the selection committee to ensure that there is balance within the group. Bringing together an understanding of the organization and its culture, competitive marketplace, required functional expertise for the role, as well as key behavioral attributes are all important factors when choosing committee members for a CEO selection.

Moreover, **committee members need to demonstrate the capacity for balanced decision making.** There needs to be an understanding that some board members will be better suited for a selection committee role than others.

This important but delicate reflection will require the Chair to exercise their experience, insight, and discretion, while gracefully informing the board and organization about the decision.

3) Stakeholder Consultations

Conducting stakeholder consultations is an effective means of collecting valuable input to help shape a CEO selection mandate. Consultations are particularly effective in organizations that place a premium on consensus-driven leadership styles.

Regardless of the organization's style, it is wise to solicit input from stakeholders and influencers across the organization well ahead of the decision-making process.

The complexity of today's economic and geopolitical environment lends further importance to reflecting broadly about what skills and competencies are required for the next CEO to be successful.

A bookend to the above activities should be a frank discussion of the overall process, timing, and the communication strategy to both internal and external stakeholders.

These elements may change once stakeholder communications begin, or may be modified with the support of a retained executive search firm prior to search launch.

4) Stakeholder Communications

An organizational change as significant as the selection of a new CEO requires a well planned and executed stakeholder communications strategy. Ultimately, a strong communications strategy should seek to achieve a balance between transparency and good corporate governance.

The Chair, the board, and incumbent CEO should work together to identify the appropriate messaging and stakeholder communication plan prior to going to market. Of course, certain circumstances will require specific communications to investors and regulators, but it is important to ensure that key stakeholders and influencers are made aware of ongoing developments.

The scope and content of the communications process will vary between organizations, but the communication strategy should accomplish the following:

·**Provide awareness** about the CEO search and its context

Outline the process, timetable, and desired outcomes

Discuss how stakeholders will be engaged during the search and onboarding process

5) Selecting an Executive Search Firm

Selecting an executive search firm is an essential task for the Selection Committee. Proper due diligence is key whether engaging with a new or existing executive search partner.

An engaged search partner should bring **financial services sector expertise, relevant experience,** and an **established network of C-suite contacts.**

While the above are fundamental to a successful search, the interpersonal skills required to collaborate and work with the board, internal senior executive leaders, and candidates will also be critical.

In short, a balance of IQ and EQ enables search partners to provide competent and candid advice to internal senior leadership and to candidates within the context of the situation and organization. The ability to appreciate context, culture, and nuance should also be a prime consideration in the selection of a search partner.

6) CEO Compensation Review

Early consideration and contingency planning regarding compensation will have significant benefits for the board and the respective committees that have input into compensation matters. A well-developed approach and philosophy will be necessary to ensure that the organization is prepared for finalist candidate discussions and negotiations. At times, fresh consideration of current compensation frameworks and potential alternative approaches is warranted.

These considerations should cover the following:

- **Review internal vs. external compensation practices**, with a focus on what is appropriate for the organization but in line with market practices

- **Prepare for "keeping whole" issues**, such as STIP forfeitures, unvested LTIP, pension entitlements, and relocation expenses

- **Prepare for redlines in advance** for instances where current programs in place might not meet finalist candidate expectations

- Remember that **compensation expectations are a business issue**, not an affront to the selection committee or organization

7) Assessment & Onboarding

Candidate assessment and onboarding should be top of mind for the board and search committee during the CEO selection journey.

ASSESSMENT

Organizations need to be aware of the assessment methodologies and tools available, as well as the strengths and weaknesses of different approaches when evaluating candidates.

It is important to remember that assessment methodologies used to evaluate other levels within an organization may not be appropriate in a CEO selection process.

The most significant decision to be made regarding testing is the leadership attributes and behaviors the assessment should focus on. At the CEO level, we suggest that assessment results should be paired with an in-depth debrief session conducted by a qualified assessment practitioner.

The debrief session provides the candidate with assessment results, but also creates an opportunity for the assessment practitioner to provide further input into the candidate's relative strengths and weaknesses.



ONBOARDING

Onboarding discussions and planning need to occur early in the selection process. Failure to think through the immediate onboarding process and outcome for the new CEO's first year substantially increases transition and integration risks.

One of the first considerations should be the identification of a potential "mentor" for the new CEO; this individual would provide support and guidance to the successful candidate. This relationship would be distinct from the formal relationship that a CEO has with the Chair of the board—the mentor relationship is designed to help the new CEO navigate situations, people, and organizational culture during the critical first year.

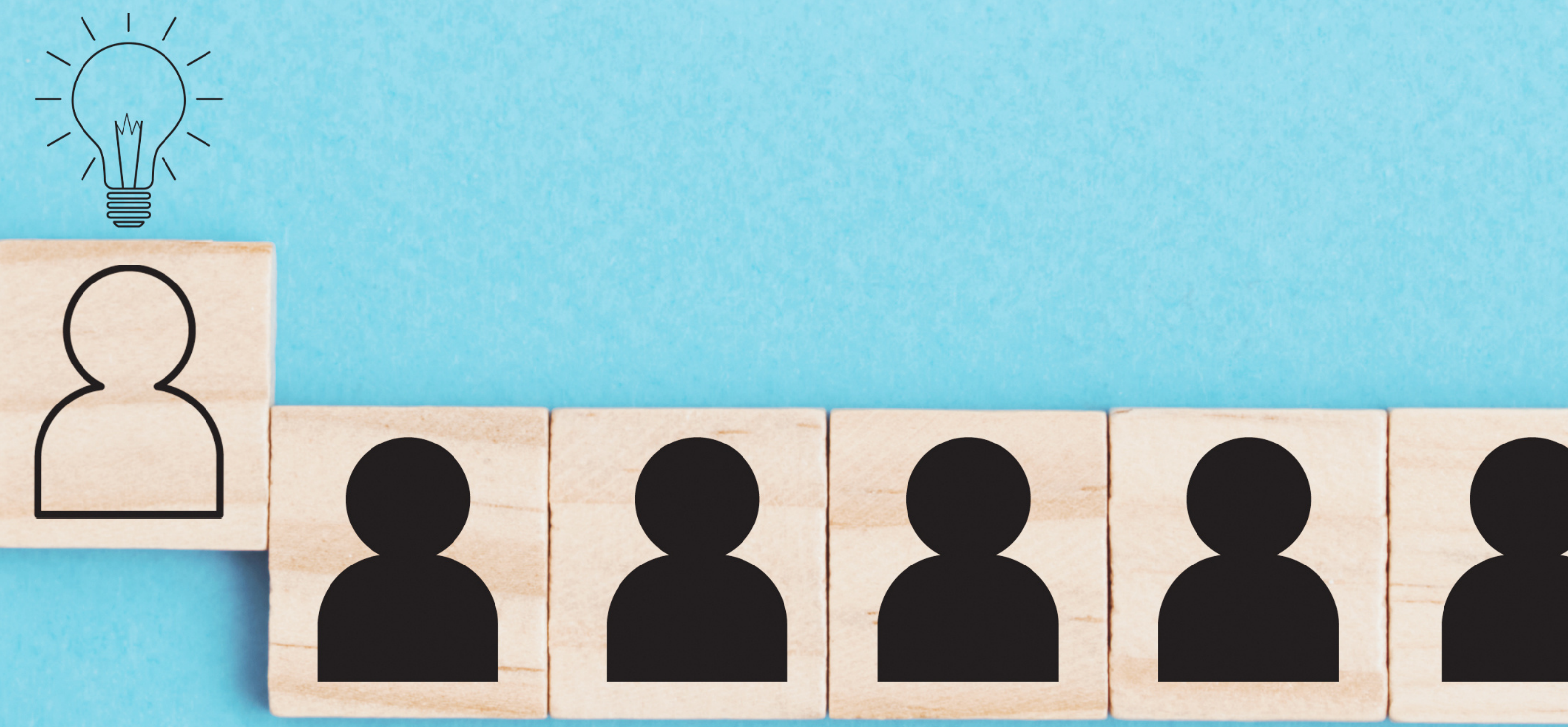
It is best to identify a few potential mentors early in the process given that the background, personality, and behavioral attributes of the successful candidate would be unknown at the outset of a search process.

Beyond the identification of mentors, the selection committee and the board at large should also **determine some of the key milestones for the first 90 days and the balance of the year**. These milestones typically involve stakeholder meetings, pre-planned strategy sessions, and of course, AGMs. These conversations also help inform the scope and extent of stakeholder communications at the outset of the search, as well during the onboarding period.

THE BOTTOM LINE

Based on the many CEO selection engagements our firm has led in recent years, and as discussed in this article, it is critical for boards to implement a structured process that regularly reviews the CEO succession planning process. They must also understand the key considerations regarding the decision to execute an internal or external CEO selection process.

Ultimately, financial services organizations that are deliberate in their approach to CEO selection will have a competitive advantage when it comes to identifying and onboarding their next CEO.



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