CEO Succession Planning and Organizational Performance: A Human Capital Theory Approach

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Chief Executive Officer (CEO) succession planning is a critical issue for organizations. The implications for an effective succession plan is far-reaching to the entire system, subsystems and external customers (Guthrie & Datta, 1998; Kesner & Sebora, 1994). This paper looks at the importance of talent management policies and practices as it relates to leadership pipelines, and provides a conceptual framework that organizations can adopt to ensure that they will always be prepared for CEO succession and maintain a competitive edge.

INTRODUCTION

The purpose of this paper is to review succession planning for the role of chief executive officers (CEO) in organizations. CEO succession planning is a critical issue for organizations that has far-reaching implications for organizational performance (Guthrie & Datta, 1998; Kesner & Sebora, 1994). The intelligence of leaders that are members of corporate boards and owners may also be subject to criticism regarding the effectiveness of their succession decisions (Elsaid, Wang, & Davidson, 2011; Hamori & Koyuncu, 2015). The past leadership experience of an executive plays a critical role in an organization's performance in the marketplace. Moreover, top leaders succeed when they nurture a culture that engages employees through challenging assignments and recognition of their contributions. Throughout this paper, inferences are drawn on insights from theories of human capital, social capital, and talent management to construct a model of succession success. Schoemaker and Krupp (2015) stated, "Successful leaders will carefully frame a decision approach from the outset, review multiple options and balance rigor with speed (Schoemaker & Krupp, 2015). Strategic leaders need to be sincere about their commitments to stakeholders, employees and gaining consensus prior to responding to signals from the business environment" (Schoemaker & Krupp, 2015).

Recent trends suggest owners are interested in leaders with significant C-level experience. Company board members want a significant role in hiring the leaders of other organizations (Hamori & Koyuncu, 2015; Karlsson & Neilson, 2009; Lucier, Kocourek, & Habbel, 2006). Company owners or corporate boards may view the hiring of experienced leaders as a less risky decision than hiring inexperienced leaders, thereby avoiding the appointment of an unknown entity. In this paper, the author explores the effect of leader succession on post succession organizational performance.

EXECUTIVE SUCCESSION AND STRATEGIC CHANGE

A common theme that emerged from this review was that corporate boards and company owners give newly appointed CEOs tremendous latitude and discretion (Bigley and Wiersema, 2002; Westphal and Fredrickson, 2001). Hutzschenreuter, Kleindienst, and Greger (2012) asserted that there is a link between leaders who possess emotional intelligence, executive experience, and enough self-confidence to trust and empower employees (Nakauchi and Wiersema 2015). According to Hutzschenreuter, Kleindienst and Greger (2012), “an increasing body of theoretical and empirical literature has since recognized the CEO as the principle leader and architect of the firm, as the individual ultimately responsible for the formulation and implementation of company strategy” (p. 730).

Next we will discuss the significant role of executive boards in the CEO succession process.

The Role of Executive Boards in CEO Succession

CEO succession is an essential strategic action to fundamentally transform the organization's direction and proactively shape the firm's vision. There is generally not an ideal situation where a seamless transition of incoming and outgoing CEOs meet and discuss what is truly in the best interests of the organization. Therefore, it is incumbent upon executive board members and major stakeholders to participate in leader retreats and think tanks that focus on executive succession. Discussing the notion of executive succession planning is a sensitive topic as no one wants to strategize about what characteristics and skill-sets should a person other than themselves possess to be a decision-maker in the organization. In most cases, an event occurs that initiates the process of involuntary succession. There are many scenarios that can unfold to initiate this event such as new career opportunities, lack of alignment with the board, personal issues, or simply deciding to retire. For the purposes of context, the circle of power is the decision-makers within an organization commonly known as the C-Suite. According to Investopedia (2015), the C-suite gets its name because top senior executives' titles tend to start with the letter C, for chief, as in chief executive officer, chief operating officer, chief financial officer, chief human resources officer, General Counsel, Chief Marketing Officer and chief information officer (Groysberg, Kelly & MacDonald, 2011; investopedia.com, 2015). Moreover, C-suite or the organizations board of directors are considered most influential in matters dealing with high-level decision-making. According to Groysberg, Kelly & MacDonald, (2011) “it is less and less common for board members to be selected by the CEO, as boards and their nominating committees have assumed primary responsibility for executive recruitment. However, it's now more common for the CEOs to owe their jobs to the boards rather than to their predecessors. That shift will mean more accountability at the top. Interestingly, boards have also become a source of CEO candidates” (Groysberg, Kelly & MacDonald, 2011). The normal course of action is that incoming CEOs inherits all the rights and responsibilities of the position (Hutzschenreuter, Kleindienst and Greger, 2012). CEO succession is a high-level plan to ensure that an organization has the competencies to sustain its competitive advantage in the marketplace. A significant organizational event such as CEO succession impacts the company’s culture and how other organizations perceive the manner in which the company is managed. CEO succession can also impact performance in a positive or negative way (Bragaw, Misangyi, 2013; Bryan, & Rafferty, 2006; Desai, Lockett, & Paton, 2015).

The Succession Process

Karaevli (2007) asserted that there is empirical evidence about the relationship between the CEO succession event and organizational performance post-succession. When executive board members have a matrix of the characteristics being sought they can then begin a comprehensive search for talent. Karaevli argues “scholars have failed to reach a consensus on whether succession events in general, and insider vs. outsider successions, in particular, affect firm performance positively, negatively or insignificantly (Karaevli, 2007).” Also, there appears to be a contradiction of succession planning literature and what occurs in corporations. The scholar-practitioner approach should focus on executive succession event and post succession performance, research into the effects of prior leadership experience on organizational performance is in its infancy (Hamori & Koyuncu, 2015). The nature of executive succession routine versus dismissal may also affect the likelihood and extent of post-succession strategic change. Executive board members should develop a profile of what qualities are needed to assume the responsibility of the chief executive and who has the business acumen to lead change. CEOs are highly compensated individuals that must develop a performance-driven culture that is adaptable. The development of a high-performance culture is the manner in which a CEO inspires stakeholder confidence. According to Kaplan and Minton, (2012), the nature of executive succession is an extremely demanding and high stakes endeavor meant to improve the organization's performance through talent acquisition, and strategic career development initiatives. In addition, the board's decision to dismiss the firm's executive may be influenced by external pressures (Wiersema and Zhang, 2011), and such cases are more likely to lead to a mandate for change. Therefore, the nature of executive succession may have an impact on both the newly appointed executive's commitment to the status quo and the discretion to pursue change (Nakauchi and Wiersema 2015).

Strategic Change

Dominguez, Galán-González, & Barroso (2015) assert that "A strategic change may imply adjustments in company strategy, structure, power distribution and control systems". First, leaders bring with them different skills and abilities depending on whether they come from inside or outside of the organization, which in turn has varying effects on performance (Cappelli, 2008; Carpenter, Sanders, & Gregersen, 2001; Gabarro, 1987). Prior executive leadership experiences demonstrate practical experience in the stewardship of large-scale financial performance and humanistic complexities associated with leading an organization effectively (Giambatista, Rowe, & Riaz, 2005; Elsaid, Wang, & Davidson, 2011). Hence, the human capital theory is utilized to provide the context of career development initiates within an organization's strategic plan for developing talent in a leadership pipeline. Human capital is premised on the investment of an individual's knowledge, skills, experiences, and abilities (Becker, 1964; Becker, 1993; Romer, 1989; Nafukho, Hairston & Brooks 2004), which can be accumulated through career development activities (Becker, 1993). Firm-specific human capital skill-sets are often considered to be germane to their specific mission and vision and may not be transferable. General skills are those that individual's gain contributes to the company and the employee's competitive advantage (Becker, 1964; Becker, 1993; Romer, 1989; Nafukho, Hairston & Brooks 2004).

Second, in order for new chief executive officers (CEO) to be successful, they must become very familiar with the organizational culture, individual board members and talented middle managers (Boeker,1997; Rowe et al., 2005; Virany, Tushman, & Romanelli, 1992; Zhang & Rajagopalan, 2003). The CEO by virtue of position is a change agent who is responsible for shaping organizational culture, business strategy, and creating an environment that supports individual, team and organizational levels to cultivate learning (Levitt & March, 1988). At the individual level, leaders need to learn about their environments, absorbing tremendous amounts of information to make appropriate strategic decisions (Rowe et al., 2005). At the organizational level, organizations can learn from the leader who brings with him or her new knowledge (Boeker, 1997; Zhang & Rajagopalan, 2003).

THE IMPORTANCE OF A CEO SUCCESSION PLAN

The precarious situation that organizations find themselves in during a CEO succession whether planned or otherwise is due to a lack of preparation. In order to ensure a competitive advantage in the marketplace, organizations must have a succession plan that includes an internal leadership talent and potential external candidates. Corporations should consider ramifications of highly-regarded CEO departures and prepare for the possibility that the successor may or may not perform optimally (Shen & Cannella, 2002b; Wiersema, 2002; Zhang, 2008). That said, the talent management process is critical to screening candidates at this level. A potential candidate should possess broad strategic leadership experience, industry knowledge, and demonstrate abilities and willingness to work in the interests of the organization (Zajac, 1990). Organizations must conduct due diligence to mitigate risks associated with negligent CEO hiring. After all of the fundamental criminal, financial, health and conflicts of interest have been investigated and cleared, organizations then should focus on the skill-sets that the executive can contribute to the organization (Bragaw & Misangyi, 2013; Huson, Parrino, & Starks, 2001). The greater the problem of asymmetric information about the succession decision, the greater the potential for firms to make suboptimal hiring decisions, which will have a negative effect on post succession performance (Day, Gordon, & Fink, 2012; Dominguez, Galan-Gonzalez, & Barraso, 2015).

Next we will discuss the importance of developing a leadership pipeline via a talent management initiatives.

Developing a Leadership Pipeline Through Talent Management

"Talent management policies and practices are those that are specifically created and implemented for the purpose of managing talent to meet the talent management challenges facing the company, such as: (a) attracting, selecting, retaining, energizing and focusing the most talented individuals; or (b) reducing or relocating these same individuals either because there is a surplus of talent; or they are in the wrong place at the wrong time; or even because there is equally valued, but less expensive talent available elsewhere" (Schuler, 2006, p. 49).

According to Baruch (2006), "the importance and prominence of organizational career planning and management (CPM) as part of an organization's competitive advantage to develop employees have been recognized widely by organizational researchers" (Maruch, 2006, p. 131). The CEO and their executive team share responsibilities for developing an organizational strategy to advance the interests of their organization. Corporations, public entities, and nonprofit organizations are experiencing challenges related to succession planning. Middle managers are not being developed for senior-level positions (Davis, 2010; Pfeffer, & Davis-Blake, 1986). The quandary is that baby-boomers are retiring and transfer of learning has not been a priority for organizations (Charan, 2005; Pazzaglia, Flynn, & Sonpar, 2012).

Organizational Career Management

Since executive coaching and leadership development initiatives are costly, those opportunities are generally preserved for managers with exceptional potential (Sparrow & Makram, 2015). During the process of developing a leadership pipeline, the executive team must take the time and conduct a thorough analysis to determine leadership characteristics that incumbents should possess. Decision-makers who are interested in attracting talented executives should be open to hiring people with different mental models and executive skill-sets that embody senior leadership excellence that achieves results (Pazzaglia, Flynn, & Sonpar, 2012). Hiring, developing, and promoting people of diverse backgrounds is cautiously considered since at times, organization leaders are myopic in their management approaches. Further, often times, the selection process of executives is less about skills, and more about cultural synergy between candidates, evaluators, and firms. Sparrow & Makram (2015) assert that at the organizational level, the value is created when organizations exploit their internal resources and capabilities to implement strategies that enable them to respond to market opportunities and conditions. Seizing opportunities is essential to creating lasting systemic stakeholder value whereby bolstering an organization's financial standing and solidifying their firms ranking. As Collings (2014, p.302) notes research has taken too narrow a view of performance and value: "performance is generally considered solely in terms of shareholder returns. This translates into HR systems that fail to align individuals and organizations in the generation of value effectively." (p. 250).

Hiring Internal Versus External CEOs

When hiring a new leader, those tasked with the succession planning and decision-making must decide whether to hire from internally or externally of the organization (Daily, Certo, & Dalton, 2000). When recruiting an outside applicant, it is always considered safe to consider a current leader of another organization versus a pool of talent not currently employed as a leader. The internal hires tend to encompass a tremendous amount of organizational politics (Shen, & Cannella, 2002). Moreover, the positive aspect is that the human resources department already has knowledge of internal applicant's past performance and opinions of others within the organization (Cappeli, 2008; Carpenter, Sanders, & Gregersen, 2001). Internal candidates tend to reflect behaviors consistent with the organization's current culture which may or may not be considered an an asset in the staffing and selection process (Cappelli, 2008; Friedman, 1986; Friedman & Olk,1995), and the informational dynamics surrounding the succession decision (Zhang, 2008).

Bailey & Helfat (2003) stated that perceptions of suitable candidates of an internal candidate is, in part, shaped by the extent to which the board feels that the candidate has the suitable human capital to lead the organization. Scholars have argued that internal candidates have the advantage of firm-specific human capital, which may enhance firm performance (Bailey & Helfat, 2003). The firm-specific human capital helps to ensure that the internal candidate is better aligned with the organization, understanding the systems and procedures, as well as having the tacit knowledge of the organization. In contrast, the outside candidate will not have firm-specific human capital, and so may not represent alignment with the requirements of the hiring organization or with its culture (Hamori & Koyuncu, 2015; Karaevli, 2007).

Lauterbach et al. (1999) found that internal successors tend to perform worse than external successors, suggesting that the internal selection decision may commonly be suboptimal. Further, research indicates that informational dynamics surrounding the leadership succession hiring decisions are complex and ambiguous. Scholars and practitioners sometimes advocate internal candidates for executive positions as these individuals understand the organization's culture, and decision-makers have significant information about the skills and abilities of internal candidates than outside candidates due to a higher frequency of interactions and internal networks (Karaevli, 2007; Shen & Cannella, 2002a; Zajac, 1990; Zhang, 2008).

Conversely, issues related to external candidates are significant since most are employed and desire confidentially during the hiring process (Gthrie, & Datta, 1998; Katz, 2001). Board members are influential people who are accustomed to broad latitude and tend not to be patient with information restrictions of candidates currently employed Cappeli, 2008; Carpenter, Sanders, & Gregersen, 2001). Thus, due to those constraints associated with external candidates will encourage boards to have a higher propensity to hire candidates, thereby making more marginal decisions instead of conducting a methodical process (Coff, 1997; Lauterbach, Vu, & Weisberg, 1999). The risk of an internal candidate is that they have already assimilated into the organization's culture and is considered to be a "known quantity" may enable the individual to "sail through a lax due-diligence process" (Charan, 2005, p. 75). Scholars and practitioners contend that the trend in hiring external candidates requires significantly more due diligence on the corporate boards' behalf in matters of corporate governance (Huson, Parrino, & Starks, 2001). Karaevli (2007) asserts that the potential positive performance effects of firm-specific human capital for internal candidates may have problems associated with informational asymmetries in their appointment. External candidates are often lured from competitors and placed directly into senior leadership positions. Likewise, leaders hired from a pool of available talent not currently in a leadership position, should be carefully evaluated to determine post succession performance projections (Graffin, Boivie, & Carpenter, 2013; McDonald, Westphal, & Graebner, 2008).

Prior Executive Experience

According to Friedman and Singh (1989), the positive effect of succession is most pronounced when the new leader's human capital has an alignment to the organization's strategic contingencies. Executive and organization alignment are critical and when the leader has the discretion to shape the organization (Guthrie & Datta, 1998). Hence, leaders that are recruited away from their current employer will provide the hiring organization with more information about their ability, as opposed to individuals who are not currently serving in leadership roles. Senior managers with a current track record tend to mitigate risks of adverse selection in selecting the new CEO (Wiersema. 2002; Zajac, 1990; Zang, &Rajagopalan, 2003). Furthermore, the leader may have been recruited based on specific knowledge, skills, and experience that the hiring organization desires (Boeker, 1997; Hamori & Koyuncu, 2015).

When a corporate executive is hired directly by another organization, the succession event is likely to be more costly due to search and compensation costs, which suggests that the leader is more likely to be the organization's number one choice (Ndofor, Priem, & Dhir, 2009; Quigley, & Hambrick, 2012). Moreover, leaders who are from other organizations are granted more autonomy to shape their new organization as compared to candidates who are serving in leadership roles (Cohen & Levinthal, 1990). Since poached leaders are outsiders to their new organizations, their early strategic changes tend to be pragmatic and since fresh perspectives (Fondas, & Wiersema, 1997). What's more, the forces against change have the limited influence of new leaders which will likely have a positive effect on organizational performance (Harris & Helfat, 1997; Zhang & Rajagopalan, 2010).

Hamori and Koyuncu (2015) assert that, experience has a shelf life that should be utilized in order to capitalize on a broad-range of CEO level expertise. When executives are exceptionally competent, and respected, they have very few barriers when it comes to a direct move from their current CEO post and then on to a new CEO role.

Friedman and Singh's (1989) asserted that post succession performance is most likely to lead to performance improvement in increments. The selection process is rational in that the potential candidate's competencies are better matched to the organization's requirements and when he or she has the discretion to shape the organization (Dokko, Wlk, & Rothbard, 2009; Dutra, & Griesedieck, 2010; Fondas, & Wiersemna, 1997). Friedman & Saul (1991) stated that executives recruited from other organizations is an indication that the leader was successful in prior positions. Prior successes tend to boost employee morale and motivate employees to accept the leader's ideas and assist the leader by providing insight of organizational idiosyncrasies (Finkelstein, & Haleblian, 2002). CEOs that were recruited from other organizations where they were well-respected tend to transition into leadership roles with tremendous autonomy and influence due to a track record of success (Murphy & Zabojnik, 2004; Murphy & Zabojnik, 2007).

According to Friedman & Saul (1991) similar situations occur in an alternate context when organizations are on the opposite side of the aggressive recruitment practices. For instance, the effects of an executive's departure create a major distraction to that executive's leadership style (Friedman & Saul, 1991). A positive indication that an executive is worth considering for a CEO position is if they are in the midst of departing for other career opportunities instead of lieu of termination scenario (Charan, 2005; Crossland & Hambrick, 2007). It would be evident that this is an exceptional leader and the firms stakeholders would not want to change the organization's current strategy and alignment. In contrast, a dismissal is an event that signals that the organization requires a change in direction (Friedman & Saul, 1991; Karaevli, 2007). The successor will likely struggle to implement strategies from their tenures onset. Entrenched cultures, institutionalized practices, and investments that are specific to the prior leader (Fondas & Wiersema, 1997; Hannan & Freeman, 1977; Quigley & Hambrick,2012; Shen & Cannella, 2002b).

CONCEPTUAL FRAMEWORK

In this article, our contribution to developing new knowledge is drawing upon insights from human capital theory (Becker, 1964; Becker, 1993; Romer, 1989; Nafukho, Hairston & Brooks 2004), and social capital theory (Bourdieu, 1977; Bourdieu 1986; Bourdieu, 1998; Coleman, 1998; Lin, 1999; Lin, 2002; Putnam, 1994; Seibert, Kraimer and Liden, 2001). The conceptual framework integrates social capital and human capital to explain the dichotomy of networks, relationships, power, and influence of the individual at the organization's helm.

According to Karaevli's (2007), internally selected CEO candidates have "stoical socialization processes, experienced executives are more likely to have narrow perspectives and psychological commitments to the status quo (Karaevli, 2007)." The next construct of emerging research focuses on prior executive experience of incoming CEO's to predict organizational performance the context human capital theories return on investment to the organization (Becker, 1993; Murphy & Zábojnik, 2004, 2007). The factors that will influence the relationship between organization performance, leader success and

CEO past leadership experiences are intertwined. The skill-sets of a leader impacts organization to learn from one another, and the potential for asymmetric information obtained during the hiring decision (Shen & Cannella, 2002b; Zhang & Rajagopalan, 2003).

Below we have provided a conceptual framework that may be useful to organizations as they develop a succession planning process.

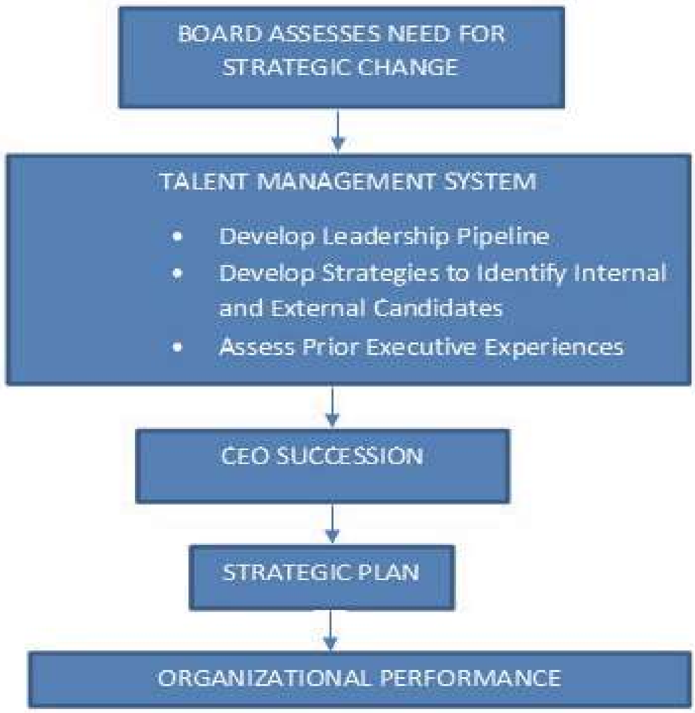

Figure 1: Conceptual Framework

DISCUSSIONS AND CONCLUSION

The abrupt departure of a CEO will lead to a significant loss of firm-specific senior-level expertise and knowledge. Without a succession plan in place, the organization will be in a perilous situation. The firm’s equilibrium will be affected and then an era of uncertainty convenes and the facts are not effectively communicated because several decision-makers may consider leaving the firm. That is why top executives must place paramount importance on developing a CEO succession plan. An executive succession plan is in the best interest of an organization to maintain their competitive advantage. High organizational performance outcomes are not merely due to the inherent properties of the resources at a leader's disposal, but rather are significantly influenced by the way in which a leader utilizes them (Brady et al., 2008; Sirmon, Hitt, & Ireland, 2007). Hence, new leaders will face a dilemma in their efforts to strategically change the organization and usher in a new era. Organizational development initiatives require methodical diagnosis, relationship building and acquiring social capital to orchestrate significant change. Conversely, CEOs that initiate planned change without proper diagnosis and developing trust throughout the organization tend to disrupt established structures and processes (Crossland, & Hambrick, 2007; Cummings & Worely, 2014). As a consequence, when a CEO is recruited, the organization loses a competitive advantage especially when a succession plan has not been established (Charan, 2005). The knowledge of how to deal with customers, investors, informal networks, and reward systems that have proven to motivate employees are often lost after a CEOs departure (Dokko, Wlk, & Rothbard, 2009; Dutra, & Griesedieck, 2010; Fondas, & Wiersemna, 1997).

Organizational Implications

Decision-makers must take full ownership of ensuring a CEO succession plan is in place regardless if the organization is a corporation, government agency, or non-profit. Succession planning should be organized and systematic. This strategic process identifies candidates for CEO and other top executive positions. However, without a strong succession-planning program, companies are not prepared to address complex business, unexpected executive departures and geopolitical demands of a global market. CEO succession planning should always be a central focus of the board of directors. The results of this review indicate that CEO succession planning encompasses strategic change, developing a leadership pipeline, and prior executive experience. The purpose of this process is to ensure that organizations have exceptional leaders at the helm to deliver results and make the necessary adjustments to both tactical and strategic plans (Karlsson & Neilson, 2009; Quigley & Hambrick, 2012; Shen & Cannella, 2002). A CEO succession plan is a blueprint for an organization to ensure viability in the global marketplace (Lucier, Kocourek, & Habbel, 2006). An effective succession plan does not occur in a vacuum as there should be significant collaboration between the current CEO, board of directors, firm owners, and other stakeholders. A comprehensive succession plan should be developed with the input from board members and must be maintained in the strictest of confidently.

Future Directions

CEO succession planning is usually the responsibility of senior-level decision-makers in the organization. Since the main functions of senior-level human resource practitioners are organization development, talent management, and career planning and talent development. Therefore, it is imperative for human resource executives who have a seat at the decision-making table must take the lead CEO succession planning (Barnett and Davis, 2008). However, many scholars believe that managing the CEO succession process is a board's ultimate responsibility. Future studies should examine whether companies that allow Chief Human Resource Officers (CHROs) to play a role in succession planning events are more successful than their counterparts who exclude the voice and input from CHRO's. Other studies (qualitative and quantitative) should also examine some of the competitive talent management practices companies are utilizing to ensure that their talent pipeline are producing future executive talent for their organization.

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