Is it Time to Replace Your CEO?

By William J. Hass, CTP and Shepherd G. Pryor IV

When you ask a CEO how his or her organization is performing, the usual self-assessment is that it's running "OK," "smoothly," or "facing a speed bump or two," even if it's really on a very rocky ride. Corporate renewal professionals dealing with underperforming companies know that convincing a CEO to face reality, admit to problems, and implement change is key to the organization's recovery. Failing that, it may be time to replace the CEO.

Causes of business breakdowns

Most businesses fail because of internal reasons. In a recent survey conducted by Buccino & Associates with Seton Hall University, 87 percent of the 1900 professional and corporate respondents believed that businesses fail because of management's inability to change, excessive levels of debt and ineffective planning. In the past 20 years, more than one million businesses have failed despite the economic expansion of the '80s and '90s.

Based on a six-year study by Dartmouth Professor Sidney Finkelstein, author of Why Smart Executives Fail (Portfolio Books, 2003), we suggest that boards ask the following four critical questions:

- Are the CEO's leadership habits dysfunctional and unsuccessful?
- Does the CEO's mindset reflect the competitive realities?
- Has the board challenged unrealistic management assumptions and solutions?
- Can management provide the board with more effective information?

Focusing on these questions soon enough can help to create organizations that can continuously renew themselves by overcoming denial and learning from their failures.

Survival requires constant tinkering and sometimes dramatic change

Even McDonald's learned this lesson recently. When profits dropped, McDonald's shifted its focus away from adding new units to improving the quality and profitability of its existing units. Its salad menu expanded when anti-obesity activists targeted fast food companies.

A healthy company's senior management uses early-warning signals to determine when to adjust strategies and road maps and when to shut down or sell under performing divisions. They feed winners and starve losers. They invest only in viable businesses and cut their losses early. They experiment and innovate but cut their losses when plans are not realized.

These concepts are part of the corporate renewal process: adjusting the business model and making the dramatic changes needed to meet the expectations of stakeholders and to position the business for survival.

When the board needs to grab the wheel

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Hundreds of turnaround experts would agree that most boards wait too long before taking action to renew an organization or a troubled business unit. They typically rely on the CEO and the senior management team to identify the problems and turn things around. After all, they've been successful in the past, and no one likes change. Ultimately when the company is in serious distress, the board has to face the tough questions: "Will a new driver perform better than the existing one? Should we grab the wheel and let one of our directors or a new CEO drive? Or, is it better to just pull over and map out a new strategy for the road ahead?"

Monitoring the success or failure of detailed action plans is the key to corporate and organizational renewal. The board should consider taking action when the company veers off-course (in or out of bankruptcy) if management:

- fails to perform according to the plan,
- deviates from the business thrust of the plan, with poor results. or
- fails to recognize and signal that the plan is no longer viable.

But, the board will not be prompted to take action unless it is measuring performance along the way. The board should work with management at the earliest sign of trouble, identify key drivers of performance, and monitor those to determine whether the business is turning down.

If the board waits too long to address the warning signals, the corporation may crash. Many board members are not aware that their fiduciary responsibilities specifically shift once their company enters "the zone of insolvency." No longer acting as the agent of the shareholders, the board must focus all of its decisions on maximizing the value of the estate for the benefit of all creditors. This dramatically changes the character of board discussions from "business as usual" to "How do we turn this around?" This question should be tackled early, as the alternatives for recovering value diminish rapidly over time.

The 7,000-member Turnaround Management Association classifies the turnaround process in five stages: 1) analysis, 2) stop the bleeding, 3) change management, 4) restructure, and 5) return to normal. Senior management teams that are unable to stop the bleeding need to be replaced or supplemented with a chief restructuring officer (CRO). The CRO works with the board to determine whether the third stage results in "changing management" or just a dramatic effort at "change management."

Outside turnaround professionals are often engaged by the board to help the management team gain a new and realistic perspective. A CRO from the outside brings a sense of urgency and an objective, critical eye to the inner workings of the company. Although turnaround management is both art and science, experience and integrity is key. Certain qualifications such as the Certified Turnaround Professional (CTP) demonstrate a background of multiple turnaround experiences, subscription to a code of ethics, a resume of client and peer references and completion of a challenging three-part examination on law, management and accounting principles.

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The Ultimate Decision

The board is the guardian of the business. The directors bear the ultimate responsibility for the renewal process and needed changes in management. It's a tough decision for any board, and it may require these “front-seat passengers” to grab the wheel if the company is headed in the wrong direction.

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*Hass and Pryor are co-authors of the book “**Board Perspectives: Building Value through Strategic Planning, Risk Assessment and Renewal**,” to be published in Fall 2005 by Commerce Clearing House.*

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