Knowledge@Wharton

Leading for the Next Act: Why CEOs Must Evolve or Step Aside

Published : August 08, 2007 in Knowledge@Wharton

Have you ever seen a mother come up and smooth the hair of her older teenager, to the chagrin and irritation of the teen, who says, "Come on, Mom, I'm not a kid anymore." It's an awkward moment: The parent has failed to recognize that overseeing her child's appearance, once a good practice, is now inappropriate.

It is common sense that parents must adapt and change their roles as children grow up. But what about CEOs, who may be hired for one task, but face an entirely different one years or even months later?

The secret to long-term CEO success, suggests David Nadler, a consultant to boards and senior executives, is conceiving of a CEO's tenure as a performance with a series of distinct acts. "Each act requires the CEO to lead, think and behave in fundamentally different ways. The successful ones are those who are able to make the transitions," Nadler said during his presentation at the 11th annual Wharton Leadership Conference, sponsored by the Center for Leadership and Change Management, the Center for Human Resources and Wharton Executive Education. The theme of the conference was "Developing Leadership Talent."

According to Nadler's model, a CEO's tenure follows a "natural arc," which begins when the CEO takes the stage, prepared or not for his or her new role, and has to solve the problems presented. "In almost every CEO succession I've seen, it isn't a case of, 'Here's the company; it's going great, don't screw it up.' Usually there is some crisis or strategic challenge, and the CEO's job is to figure out how to respond." Often, says Nadler, a CEO may be hired precisely because he or she is perceived to be strong in the area where the company most needs help, whether that be changing the culture or bringing innovation.

"The problem comes after the CEO solves that first issue; then it is act two and something else is needed," he says. Many CEOs fail because of what Nadler terms "success syndrome," that is, codifying a certain way of doing things, and then charging ahead with the old game plan no matter how the context has changed.

Exiting Stage Right

To make the point, Nadler referred to the five-and-a-half-year tenure of Carly Fiorina as CEO of Hewlett-Packard. Although her controversial acquisition of Compaq and high-profile firing in 2005 led many critics to say she failed entirely as CEO, Nadler asserted that, in his view, Fiorina actually made the right moves, at least early on in her leadership. "In act one, she was required to create a transformation at HP, develop a new strategy, break the static elements and reshape the business through the acquisition," says Nadler. "Given that [current CEO] Mark Hurd has kept the same fundamental strategy, she probably did the right things."

Fiorina's problems began, adds Nadler, when her act one concluded, and a new task emerged -- execution. A "hunkering down," not a CEO in the limelight, was needed to get the job done. "Instead, she continued on the same approach, and the leadership model that had been successful in act one killed her in act two."

For a counterpoint to Fiorina's failure, Nadler looked to E. Stanley O'Neal, who took the helm of Merrill Lynch just three months after the terrorist attacks of 9/11 literally blew the business advisory company out of its global headquarters in Manhattan. Unfortunately for O'Neal, the business's problems ran deeper and were reflected in a low stock price and rumors of a takeover. O'Neal approached this set of challenges with a management style Nadler described as "demanding, almost brutal at times"; he focused relentlessly on

Knowledge@Wharton

control, discipline and cost. "His feeling was, 'I have to save the company. If I don't do this, we'll be finished and thousands of jobs will be gone.'"

The company began to recover, however, and by the fall of 2003, O'Neal did something different: He changed his entire executive team, focused on growth and rethought his own leadership style. Today, says Nadler, with Merrill Lynch stock trading at nearly three times the amount it did in 2001, O'Neal is focusing on building up the next generation of leaders. For example, he created two co-presidents who operate alongside him as co-CEOs and now "conceives of his job primarily as being a mentor, coach and supporter," says Nadler.

What leaders who successfully transition from one act to the next share is an awareness of what kind of leadership is required at the right moment -- and they don't rest on their laurels. According to Nadler, O'Neal appreciates his past success, but continues to worry about missing other transitions in the future. This is because even CEOs who manage to navigate multiple acts will find themselves with a final challenge: exiting the stage successfully. It's a task that usually means answering the question: "Did I leave the business with effective leadership?"

"The Death Spiral"

Nadler knows something about being a long-lived leader. He founded Delta Consulting Group in 1980 and ran that company for 25 years. Several years after Delta joined Marsh & McLennan Companies to become Mercer Delta Consulting in 2000, Nadler says, "I looked around and realized the only CEO in power longer than me was Fidel Castro."

After planning for his succession, he retired in 2005 -- only to be drafted in 2007 into the role of vice chair of Marsh & McLennan; he now divides his time between that job and research and writing about leadership, particularly CEO leadership. He accepted the position as vice chair of the $12 billion public company because it was a "new challenge." After a career often spent advising boards, "I thought I'd learn something sitting on the other side of the table," notes Nadler, author of the 2005 book, *Building Better Boards*. Nadler's comfort on both sides of the table may reflect his academic training, which included not only an MBA from Harvard Business School, but also a PhD in psychology from the University of Michigan.

Early in his consulting career, Nadler says, he was privileged to work with "fabulous leaders who created fabulous institutions," including David Kearns, who led a turn around at Xerox in the 1980s, James Houghton, who was CEO at Corning for 13 years, and Henry Schacht, who oversaw the 1997 spin-off of Lucent Technologies from AT&T.

In the mid-1990s, however, Nadler began to see CEOs who performed well in their first seven or eight years "and then suddenly something happened." For example, Nadler worked with Robert Allen, who served as CEO of AT&T for nearly 10 years. "Had he retired in 1995, he would have been seen as the hero for splitting and reshaping the company -- but his career didn't end that way." Rather, he was blamed for sparking a leadership crisis by picking an inappropriate successor. Other failures Nadler witnessed first hand included that of Richard Thoman, the short-lived CEO at Xerox, and Richard McGinn, who was ousted by his board at Lucent.

"That started me thinking about the difference between success and failure," says Nadler. "I realized it might be more interesting to study failure because success is transient, but failure is reasonably permanent." Together with his colleagues, Nadler looked first at "early" CEO failure, in which individuals had fantastic careers before they became CEOs and then promptly failed at their new job. Then Nadler became interested in "late" CEO failure, in which CEOs who have a solid tenure screw up at the end, often because of staying too long or not having the right successor.

Finally, Nadler focused his research on CEOs who came into the job, did well for a time, but, when the situation changed, had a hard time adjusting their leadership accordingly -- in other words, CEOs who couldn't move from one act to the next. "They fail to recognize that things are changing, and often, they are unable to assess their own capabilities." With these blind spots in place, the CEOs continue to press ahead, widening the gap between their vision and the company's reality. "We call that 'the death spiral,'" said Nadler, giving the example of Thoman's insistence on setting higher and more ambitious goals at

Xerox, even as his leadership team was falling apart around him.

Feeding into this negative cycle is the hard fact that CEOs may not hear frank words from their insular circle of advisors -- or care to listen when the truth is spoken. "Normally we think of learning-disabled kids, but I see learning-disable executives, who lack the ability to take in new information and determine the insider implications for it."

The Need for Self-Assessment

The most "heartbreaking" kind of failure, says Nadler, is when CEOs try to change but can't. "We are not infinitely malleable. Asking a person who is 55 to act dramatically differently, and pull it off naturally, is setting a very difficult-to-achieve goal."

Part of the CEO's task, then, is to ruthlessly assess him or herself as the business context changes. "Do I have an understanding of what's needed now in terms of new leadership requirements? Do I have a sense of my own leadership capabilities? Can I understand the gap between what's required by the new situation and what I'm capable of doing?"

According to Nadler, Kenneth Freeman's recent decision to retire as CEO of Quest Diagnostics at age 52, after overseeing Quest's successful spin-off from Corning, is an example of good self-assessment. "He took the firm from a period of trouble, in a troubled industry, and created a great organization. He was able to say, 'I loved turning this thing around, and the next stage is probably not a good fit with who I am.'" Interestingly, says Nadler, Freeman is now with the private equity firm KKR, working serially with companies who need a short burst of turn-around leadership.

The implications of Nadler's research for the boards that make CEO hiring decisions are several. First, boards should look for what Nadler calls the "sustainability factor." This means assessing the candidates' range of experience to see if they can not only handle the current crisis, but also deal with unknown future crises. "Have they run mature businesses? Handled compliance issues? Done a turn around? Grown globally? That's different than someone's who has done the same act over and over again."

Locating such a jack-of-all-trades may be near impossible in some situations, and in these cases, Nadler recommends that boards consider the idea of a "one-act CEO," hired on the basis of a renewable contract. "To find someone who is going to be a three- or four-act CEO may be an unreasonable expectation. Maybe we ought to make it okay to hire someone who takes the company to a certain point, understanding that then we'll need a different set of skills."

Such a rethinking of the CEO role, however, requires a change of mindset for both boards and chief executives. Early succession "is not part of our normal view of the heroic CEO, who stays on the bridge until he brings the ship home," says Nadler.

But as one questioner in the audience pointed out after Nadler's talk, having a one-act CEO requires a "multi-act board," one that can fit the current CEO into the board's long-term vision. Nadler agrees, pointing to how, in the past seven years, boards have become much more involved with CEO succession, whereas before they had only a signing-off role.

And with this greater freedom to select the CEO comes a greater responsibility to manage his or her tenure. Boards, says Nadler, "need to face the facts when they need to make a change."