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LEADERSHIP

How companies can avoid CEO hiring failure

Here are three ways in which companies can avoid a Yahoo-like debacle.

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Some of the best companies in the U.S. have failed, very publicly, to rigorously check references on CEO candidates to ensure that they are the right fit for the company's challenges ahead. Yahoo learned this lesson the hard way last week when it was revealed that their CEO, Scott Thompson, padded his resume.

Now Yahoo (YHOO) board member Patti Hart, who led the executive search that resulted in Thompson's hiring, plans to step down from the board. For the more than 4,000 executives currently serving on Fortune 500 boards, or considering joining one, these events concerning Yahoo should be a wake-up call.

When these issues are not surfaced before the CEO is hired, the result can be both public embarrassment — for the company and the executives from other companies that serve on its board — and a jolt to shareholder and employee confidence in leadership. And checking academic pedigrees is the easy part. The more difficult challenge is getting the hard data from the market to ensure that your CEO pick is right for the job. Just look at Hewlett-Packard (HPQ), where shareholders were stripped of 40% of their stock value under Leo Apotheker last year. One HP director recently told us that Apotheker had been "sold to the board" and "that won't happen again."

Similar misfires have happened not only at Yahoo but also at companies like Motorola (MSI), Coke (KO), and Procter & Gamble (PG). When the wrong person is picked, recriminations and questions immediately begin with, "Why didn't we know this before?" The best companies put in place systems to ensure that they do. P&G, for example, was highly successful the next time around because it dug deeper into the organization and based CEO selection on better information, which led to the selection of CEO A.G. Lafley.

Many companies make a final hiring decision with too little information and too much delegation, and rely too heavily on third parties to get the job done. Fortunately, there is a great deal that can be done to improve the process.

Companies must go beyond superficial referencing to determine what a candidate can contribute and how he or she aligns with the future imperatives and culture of the company. But unlike referencing for other senior executive positions, referencing for CEO contenders is tricky because in many cases the person up for the job has never been a CEO before.

Here are three ways in which companies can avoid a Yahoo-like debacle:

Make sure the board is involved

Patti Hart's departure from Yahoo's board underscores a crucial point: Hiring the CEO goes to the heart of a board's fiduciary duties, so it makes sense that referencing begins and ends with the directors. Even when working with a third party, such as a search firm, boards should never completely hand off the referencing process. Directors should be a check on referencing, especially if they have a personal relationship with a reference. If a board is going to rely on a third party to take care of the referencing process, as many companies do, the directors need to make sure that that group can get the "inside scoop" on how a candidate leads. We've seen the consequences of boards that relinquish control of the referencing process. It's not pretty.

Go beyond the customary assessment process

The traditional internal assessment process is designed to assess a candidate in his or her current position, not whether the individual is great CEO material. Use that process as an entrée to a second round of references, which will add insights. When GlaxoSmithKline (GSK) was planning for the departure of CEO Jean-Pierre Garnier in 2008, it supplemented its customary assessment with 14 interviews with internal executives who had worked directly or indirectly with all three internal CEO candidates. The questions were designed to assess the suitability for the CEO position, and feedback was shared with Garnier and the board. Now-CEO, Andrew Witty, while not the obvious choice at the time, emerged as a much better candidate than his competitors.

Keep it confidential

We have seen stellar candidates drop out of consideration when their candidacy is made public. One solution to this problem: When referencing for CEO candidates, companies can ask knowledgeable industry insiders to evaluate a candidate for a potential director position, rather than the CEO spot, which encompasses many chief executive skills.

Most large companies hire consulting firms to make sure they get a complete picture of a CEO finalist through references and, indeed, people offering references will often speak about a candidate differently to a board director than they would to a third party. In a recent CEO search we did for a Fortune 100 company, the board utilized a two-way process for conducting references where several referees spoke independently with both a director and the consultant.

Hiring a new CEO will inevitably involve an element of risk. With instant access to information, companies must make it their mission to learn everything possible about candidates, before an appointment is made. That's the surest way to avoid unpleasant surprises the day after the big announcement or the pain of having the "real" story dribble out.

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