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How new CEOs can boost their odds of success

A data-driven look at the link between the strategic moves of new CEOs and the performance of their companies highlights the importance of quick action and of adopting an outsider's perspective.

by Michael Birshan, Thomas Meakin, and Kurt Strovink

The success of CEOs is deeply linked to the success of the companies they lead, but the vast body of popular literature on the topic explores this relationship largely in qualitative terms. The dangers of these approaches are well known: it's easy to be misled by outliers or to conclude, mistakenly, that prominent actions which seem correlated with success were responsible for it.

We tried to sidestep some of these difficulties by systematically reviewing the major strategic moves (from management reshuffles to cost-reduction efforts to new-business launches to geographic expansion) that nearly 600 CEOs made during their first two years in office. Using annualized total returns to shareholders (TRS), we assessed their companies' performance over the CEOs' tenure in office. Finally, we analyzed how the moves they made—at least those visible to external observers[1]—and the health of their

[1] There are, of course, a number of important factors (such as inspiring the top team and role-modeling a new culture) that play an important part in explaining a CEO's performance, even though these factors cannot always be observed externally. For a perspective on them, see Ian Davis, "Letter to a newly appointed CEO," *McKinsey Quarterly*, June 2010, McKinsey.com.

companies when they joined them influenced the performance of those companies.[2]

The results of this analysis, bolstered by nearly 250 case studies, show that the number and nature of the strategic moves made by CEOs who join well- and poorly performing companies are surprisingly similar. The efficacy of certain moves appears to vary significantly across different groups of companies, however. What's more, the sheer number of moves seems to make a difference, at least for CEOs who join poorly performing companies. Also, external hires appear to have a greater propensity to act.

These findings have important practical implications for new CEOs and the boards that hire them: focus early on a few bold moves well suited to the context of your company, and recognize the value of the outsider's perspective—whether or not you are one.

SURPRISING SIMILARITIES

The starting point for our analysis was a group of nearly 600 CEOs who left S&P 500 companies from 2004 to 2014 (identified in the annual *CEO Transitions* report produced by Spencer Stuart, the global executive-search and leadership-consulting firm).[3] For each CEO's first two years, we gathered information—from a range of sources, including company reports, investor presentations, press searches, and McKinsey knowledge assets—on nine strategic moves that chief executives commonly make.

We expected that CEOs taking the helm at poorly performing companies, feeling compelled to do something to improve results, would have a greater propensity to make strategic moves than those who joined well-performing organizations. To learn whether this idea was true, we looked at how each company had been performing relative to its industry counterparts prior to the new CEO's arrival and then subdivided the results into three categories:

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[2] Total returns to shareholders (TRS) indicate the returns a company provides to its shareholders in share-price appreciation and dividends. We have annualized TRS over the course of a given CEO's tenure to provide for comparisons among companies and over time. In this article, we use excess TRS, a company's returns normalized for the performance of its industry counterparts over the same period. Excess TRS is a more equitable measure than company TRS since it assesses a company's over- or under-performance relative to the market.

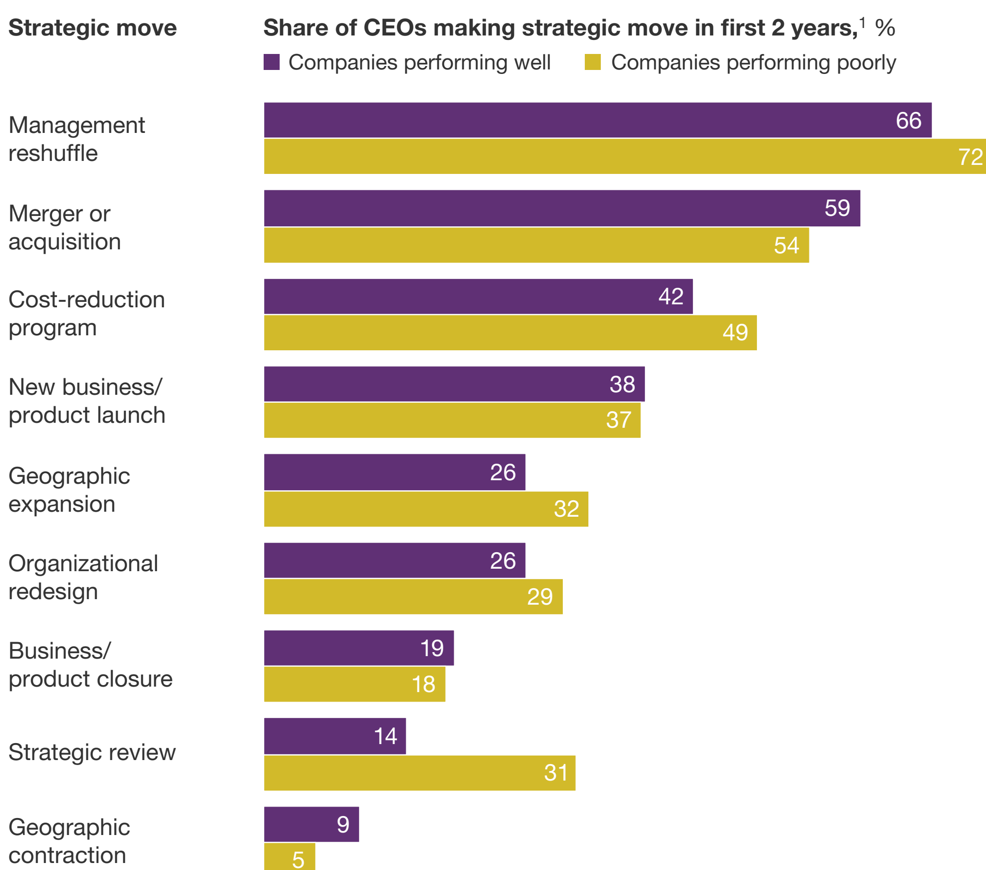
[3] For the latest report, see *2015 CEO Transitions*, March 2016, www.spencerstuart.com. For a write-up by Spencer Stuart on CEO transitions from 2004 to 2008, see James M. Citrin and Dayton Ogden, "Succeeding at succession," *Harvard Business Review*, November 2010, Volume 8, Number 11, pp. 29–31, hbr.org.

well-performing, poorly performing, and stable companies.[4] When we reviewed the moves by companies in each of these categories, we found that new CEOs act in similar ways, with a similar frequency, whether they had joined well- or poorly performing organizations. CEOs in different contexts made bold moves—such as M&A, changing the management team, and launching new businesses and products—at roughly the same rate (Exhibit 1).

[4] We examined economic profit, a measure of the value a company creates over a sustained period of time. If a company's annualized EP growth in the five years before a CEO joined was, on average, more than 5 percent a year above that of its industry counterparts, it was classified as well performing; if it was more than 5 percent a year below that of those counterparts, it was classified as poorly performing; and if it was between these two figures, it was classified as stable.

Exhibit 1

No matter the context, CEOs make strategic moves at roughly the same rate.



[1]Based on a sample of ~600 CEOs who left S&P 500 companies between 2004 and 2014.

CONTEXTUAL CONTRASTS

Although new CEOs transitioning into companies that have been performing well and CEOs transitioning into companies that have been performing poorly make similar moves with a similar frequency, that doesn't mean those moves are equally effective. We measured the performance of companies by excess TRS over a CEO's tenure. At companies where chief executives made strategic moves early on, we found striking contrasts between organizations that had been performing well when the new CEO took charge and those that had been performing poorly:

- Organizational redesign was correlated with significant excess TRS (+1.9 percent) for well-performing companies, but not for low performers.

- Strategic reviews were correlated with significant excess TRS (+4.3 percent) for poorly performing companies but were less helpful for companies that had been performing well.

- Poorly performing companies enjoyed +0.8 percent TRS when they reshuffled their management teams. But when well-performing companies did so, they destroyed value.[5]

We recognize that excess TRS CAGR does not prove a causal link; too many other variables, some beyond a CEO's control, have an influence. But we do find the differences that emerged quite plausible. It stands to reason that troubled companies would enjoy special benefits from major overhauls of management or strategy. Organizational redesigns are challenging for all companies and may, in some cases, be premature for organizations in significant flux.[6] Also plausible was the finding that cost-reduction programs appear to improve a company's TRS relative to those of its counterparts for both well- and poorly performing organizations, though the effect is strongest for weak ones.

A final point on context is that the bar for top performance varies significantly by sector. In some, such as investment services and automotive, the TRS CAGRs of top-performing organizations with new CEOs are more than 16 percent above those of their industry counterparts. In other sectors,

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[5] We define a management reshuffle as a more than 50 percent turnover of a new CEO's direct reports within two years of taking office. Of course, even CEOs in high-performing companies need an effective, aligned top team, though this may not require shuffling more than half of it.

[6] For a further discussion of the conditions necessary for a successful organizational redesign, see Steven Aronowitz, Aaron De Smet, and Deirdre McGinty, "Getting organizational redesign right," *McKinsey Quarterly*, June 2015, McKinsey.com.

such as media and telecommunications, a CEO's company must outperform the market by only a few percentage points to be classed in the top quintile. The implication is that new CEOs seeking to calibrate their starting points and to prioritize strategic moves should look beyond top-level performance metrics to understand what it will really take to beat the market.

BOLD BOUNCEBACKS

We also sought to compare the number of major moves that new CEOs made in parallel at well- and poorly performing companies. Well-performing companies had no discernible pattern. But in poorly performing ones, CEOs who made four or more strategic moves at the same time during their first two years achieved an average of 3.6 percent excess annual TRS growth over their tenures. Their less bold counterparts in similarly bad situations could claim just 0.4 percent excess annual TRS growth.

These findings are in line with earlier McKinsey research[7] showing how difficult it is to reach higher levels of economic profit without making substantial strategic or operational shifts. That has also been our own experience working with new CEOs on turnarounds.

OUTSIDE VIEWS

When the time comes to appoint a new CEO, corporate boards face a difficult question: promote an executive from within or choose an outsider? We turned our own lens to this issue and found that the performance of outsiders and insiders differed significantly. Externally appointed CEOs have a greater propensity to act: they were more likely to make six out of the nine strategic moves we examined. The size of the gap in frequency—in other words, the chance an external CEO would make a particular move minus the chance an internal CEO would do the same thing—was much greater for the moves external CEOs opted to make (Exhibit 2).

External CEOs almost certainly have a leg up when it comes to bold action. They are generally less encumbered by organizational politics or inertia than their internal counterparts. They may also be more likely to take an outside view of their companies. It's no coincidence, in our view, that the strategic moves that have the largest gaps in the propensity to act include some of the most far-reaching ones: organizational redesign, for example, or geographic contraction.

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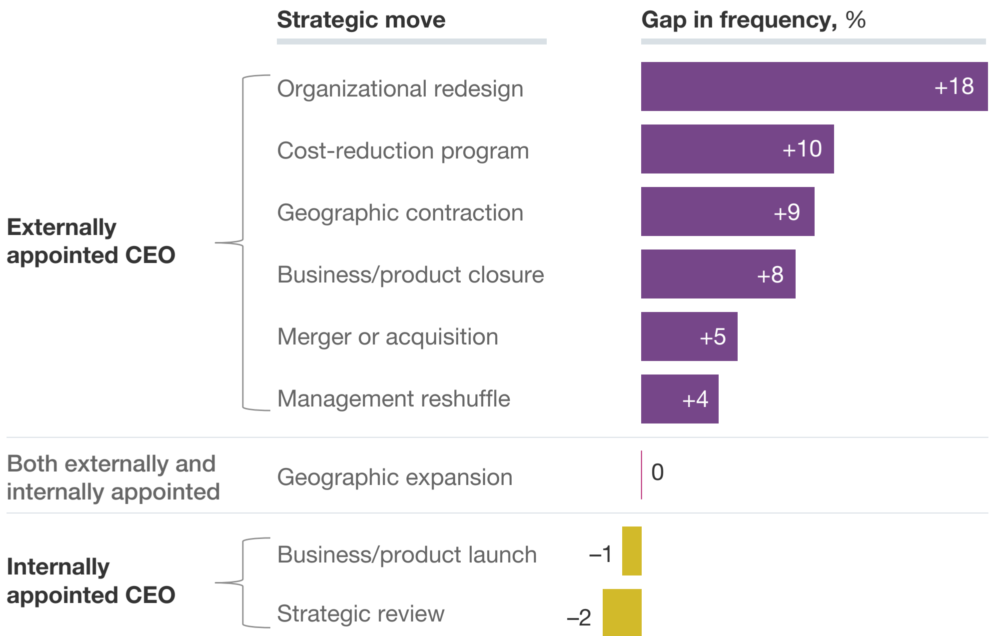
[7] See Chris Bradley, Angus Dawson, and Sven Smit, "The strategic yardstick you can't afford to ignore," *McKinsey Quarterly*, October 2013, McKinsey.com; and Stephen Hall, Dan Lovallo, and Reinier Musters, "How to put your money where your strategy is," *McKinsey Quarterly*, March 2012, McKinsey.com.

Exhibit 2

CEOs who are appointed to companies from outside have a greater propensity to act than those promoted from within.



Poorly performing companies are more likely to appoint external CEOs, and corporate performance tends to revert to the mean. But the TRS edge of outside hires was substantial: over their tenure, they outperformed their internally promoted counterparts by a margin of more than five to one—on average, a 2.2 percent excess TRS CAGR, compared with 0.4 percent.

Clearly, this performance differential is the result of multiple factors, and it's important to note that new CEOs need not come from outside companies to cultivate an outsider's mind-set—or to be successful in their role.[8]

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[8] On average, the external CEOs in our database outperform their internal peers, but a majority of top-quintile CEOs are internal, indicating that many internal CEOs can make the bold moves necessary for success. This finding corresponds with those of a recent *Harvard Business Review* article, "The best-performing CEOs in the world," November 2015, Volume 93, Number 11, pp. 49–63, hbr.org. Our analysis also supports Joseph Bower's in "Solve the succession crisis by growing inside-outside leaders," *Harvard Business Review*, November 2007, Volume 85, Number 11, pp. 91–96, hbr.org.

While our results are averages across multiple organizations and industries, they do suggest a few principles for new CEOs:

- *Adopt an outsider's mind-set.* On average, external hires appear to make more moves during their early years. This doesn't mean that insiders are the wrong choice for boards. But it does suggest that it's critical for insiders to resist legacies or relationships which might slow them down and that approaches which help insiders adopt an outsider's mind-set have great potential. Equally, there is value in having outsiders who can lean into the boldness that their status naturally encourages. Some executives have done so by creating new ways to assess a company's performance objectively—for example, by taking the view of a potential acquirer or activist investor[9] looking for weak spots that require immediate attention. Others have reset expectations for the annual allocation of resources, changed the leadership model and executive compensation, established an innovation bank, and looked for additional ways to bring an external perspective to the heart of the leadership approach.

- *Don't follow the herd.* On average, new CEOs make many of the same moves, regardless of starting point. They will do better, however, by carefully considering the context of their companies and leveraging more scientific ways to assess their starting points. For instance, some new CEOs take stock of the economic-profit performance of companies relative to that of their peers and, in light of the starting position, assess the odds that potential moves will pay off.[10]

- *When you're behind, look at the whole playbook.* On average, CEOs taking the helm at underperforming companies do better when they make more major strategic moves, not fewer. That doesn't mean they should try to do everything at once, but it does suggest a bias toward boldness and action. Plan a comprehensive set of moves that will significantly improve your company's performance, and make sure that you aim high enough.[11]

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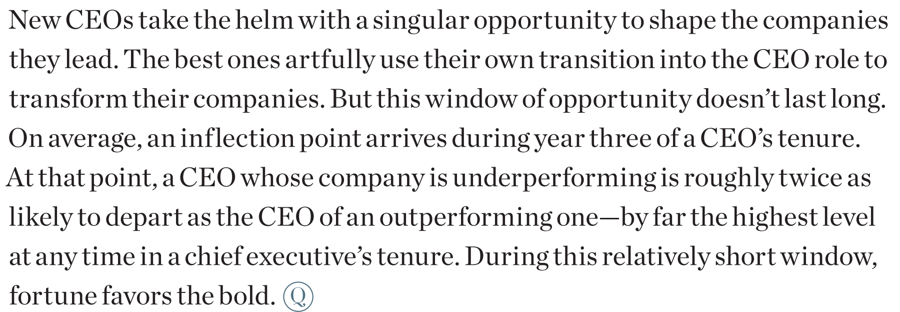
[9] For ideas on how activist investors think about business performance, see Joseph Cyriac, Ruth De Backer, and Justin Sanders, "Preparing for bigger, bolder shareholder activists," March 2014, McKinsey.com.

[10] See Chris Bradley, Angus Dawson, and Sven Smit, "The strategic yardstick you can't afford to ignore," *McKinsey Quarterly*, October 2013, McKinsey.com.

[11] For more on the highest-leverage internal actions a CEO can take to influence a significant shift in company performance, see Carolyn B. Aiken and Scott P. Keller, "The CEO's role in leading transformation," *McKinsey Quarterly*, February 2007, McKinsey.com. To determine whether your strategy is comprehensive and will position your company for success, see Chris Bradley, Martin Hirt, and Sven Smit, "Have you tested your strategy lately?," *McKinsey Quarterly*, January 2011, McKinsey.com. For tips on designing a transformation program for a company that's in trouble, see Doug Yakola, "Ten tips for leading companies out of crisis," March 2014, McKinsey.com.



New CEOs take the helm with a singular opportunity to shape the companies they lead. The best ones artfully use their own transition into the CEO role to transform their companies. But this window of opportunity doesn't last long. On average, an inflection point arrives during year three of a CEO's tenure. At that point, a CEO whose company is underperforming is roughly twice as likely to depart as the CEO of an outperforming one—by far the highest level at any time in a chief executive's tenure. During this relatively short window, fortune favors the bold. Ⓠ

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