McKinsey&Company

CEO transitions: The science of success

August 2016

New CEOs are faced with a bewildering array of choices, so it's crucial for them to take a data-driven look at potentially major moves—and to know when to make them.

How does a new CEO get off to a great start? The best leaders move boldly and swiftly to transform their companies as they are transitioning into the new role. In this episode of the *McKinsey Podcast*, partner Michael Birshan and associate partner Thomas Meakin talk with *McKinsey Quarterly* editor in chief Allen Webb about their research into the strategic moves of nearly 600 CEOs, as well as how those moves influenced company returns and the CEOs' tenure. An edited transcript of their conversation follows.

Podcast transcript

Hi, I'm Allen Webb, editor in chief of *McKinsey Quarterly*. I'm in Seattle today, and I'm delighted to be speaking with Michael Birshan, a partner and leader of the firm's Strategy & Corporate Finance Practice in London, and Thomas Meakin, who is in Cologne today, but is an associate principal located normally in the London office. Michael and Thomas, along with their colleague, Kurt Strovink, were the coauthors of a recent *McKinsey Quarterly* article called "How new CEOs can boost their odds of success." It's a data-driven look at the strategic moves that new CEOs can make. Michael, Thomas, thank you very much for spending some time with us here today.

Michael Birshan: Thanks, Allen.

Thomas Meakin: It's great to be here, Allen.

Allen Webb: Let me start with the obvious question. Why write an article about how to be a new CEO? It seems like there are a lot of books and articles about this. Why write another one?

Michael Birshan: There are indeed, Allen, but I think that a lot of the existing literature is quite qualitative, anecdotal, and we've been able to build a database of 599 CEO transitions and add a bunch of other sources to it and really try and mine that database hard for what we hope are new insights. We are really trying to move the conversation from alchemy to chemistry, if you like.

Allen Webb: And what did the data tell you that surprised you when you looked at those 599 case studies?

Thomas Meakin: I think there were a few things, Allen, but one stands out more than others, which is that the types of moves CEOs make typically in their first couple of years in office don't really vary by context. So, within our sample set, we divided CEOs into two groups, depending on how their company was doing in the years before they took over as CEO. Then within those two groups, we looked at the strategic moves that these leaders made—everything from a strategic review to a management reshuffle, to entering or exiting a new product line or a geography.

We expected different CEOs, depending on the context, to do things very differently. They didn't. Management reshuffle was the most popular for everyone, geographic contraction was the least popular in every instance, and the differences in distribution or frequency at the individual-move level didn't change significantly, with one exception, as you might expect: a strategic review. We found that CEOs who took over companies that were doing poorly in the run-up to their transition were almost twice as likely to review that strategy as you might expect.

Allen Webb: How do you account for that similarity?

Michael Birshan: I wonder whether it's almost as if there's kind of a chief-executive playbook. There are a number of things you do when you're new to the role, and what differentiates the better performers from the less successful chief execs is not what they do but whether those actions are, in fact, appropriate to the context they're in. If you use the standard playbook that you see other peers using in the wrong context, then it's not going to work out well for you.

Allen Webb: So did your data support that idea, that context matters?

Thomas Meakin: It did. Unlike the frequency question, the context that a CEO found him or herself in when they took over made a significant difference in how effective different strategic moves were. An organizational redesign, for example, was very beneficial to CEOs who took over companies that were performing well but caused chaos and destroyed values in organizations that were doing poorly. In contrast, a strategic review was much more beneficial in organizations that were having some trouble, as was reshuffling their management.

Michael Birshan: On average. There'll always be company-specific context, but if you look at the averages, that's the story.

Allen Webb: How did you measure performance?

Thomas Meakin: The metric we used was total returns to shareholders—a measure of share-price appreciation and dividends. But of course, we need to make it comparable between companies and across industries, so we used what we call excess total returns to shareholders, or excess TRS, which is the performance of one company over or beneath the average performance of its industry peers over the same time period.

Allen Webb: If a new CEO came to you feeling overwhelmed by the mess that he or she had inherited, what would you say to do first based on your research on strategic moves?

Michael Birshan: Take a deep breath and get ready. I think the reality is that chief executives in underperforming companies are much more successful in generating outsized returns if they pull multiple levers at once. If you're in an underperforming situation, use the whole playbook, throw the kitchen sink at it. The data shows that chief execs inheriting poorly performing companies, who made four or more strategic moves in the first two years, achieved, on average, annual TRS growth 3.6 percentage points ahead of peers. But their less bold counterparts who used one or two or three moves were only 0.4 percent ahead. So there's a real difference if you're behind in going bold and going hard.

Allen Webb: What's the worst thing a new CEO can do?

Michael Birshan: The worst thing is probably to not do very much and to sit on your hands. If there's one big takeaway we have from this research, which also corresponds with what I see in my own client work, and what a number of my colleagues see, it's that fortune favors the brave. Chief executives who inherit a situation and stand still will often find that if it's good performance, it will revert to the mean, and if it's bad performance, it won't get better.

Some of the other research I've done has focused on resource allocation, and what you see is that many companies don't shift their resources very fast between business units or opportunities. And if you snooze, you lose. Those companies that do shift more aggressively outperform. If you are fortunate to inherit a well-performing company, it's still going to take agility and constant vigilance to stay ahead.

Allen Webb: Did you learn anything that would be useful for boards of directors who were thinking about hiring new CEOs? What should they be thinking about based on your research?

Michael Birshan: If you look at the data set as a whole, you find that chief executives who are outsiders to the company, on average, outperform those who are insiders. The first lesson for a board is, if you are appointing an insider, which will often make a lot of sense, make sure that that insider is given the space and the support and has the mind-set to be as objective as an outsider. Are they really the kind of person with the insight and the courage to challenge sacred cows, to reverse decisions that, perhaps, they had been involved as a member of the executive committee in making? Are they going to bring the dispassionate objectivity of an outsider, even if they're an insider?

And then the other thing I would say is, if you look at the top quintile, the top 20 percent of chief executives in our data set, insiders are overrepresented there. The lesson for boards, similarly, if you're appointing an outsider, is how quickly they are going to figure out where the levers of influence are, where the challenges are, and where the bodies are buried. Have they had experience taking on one of those situations previously in their career and doing that job well?

The reality is, if you can marry the dispassionate objectivity and readiness to make change of an outsider with the understanding of the organization and how to influence things of an insider, then you're going to get the best of both worlds. If you can find that in a chief exec, wherever he or she comes from, that's probably the person you're looking for.

Allen Webb: You're saying on average there seems to be an edge to having an outside hire, however, the absolute top performers are disproportionately represented by insiders. Is that right?

Thomas Meakin: It's exactly that. If you look on average across the entire data set, external CEOs outperform internal CEOs by a margin of about five to one, but if you look at the top-performing CEOs, the overwhelming majority of those CEOs are insiders. They're individuals who manage to combine the boldness, the external perspective, and the willingness to challenge sacred cows with the knowledge of how to influence the organization that insiders have as an advantage.

Allen Webb: Is it possible that the people in the top group started out with stronger companies and that's why they promoted an insider to begin with, because they were happy? Or did the research control for that sort of thing?

Thomas Meakin: It's a really good point. The research tried to control for that. One triangulation point is the propensity of boards to hire externals and internals, depending on how their company was doing. Interestingly, we found that even if a company was doing poorly, it was no more or less likely to hire an external CEO than it was an internal CEO. There were some small differences, but these were not significant and don't determine the outcome. We genuinely believe that the boldness that typically goes with being an external CEO does lead to outperformance over tenure.

Allen Webb: You've said a couple of times that it's important for CEOs to be bold, to be brave. I wonder if there is a counterargument to that, which is that you can really mess up a company if you move too fast, before you understand what's going on. I got a chance to interview Pixar's president, Ed Catmull, recently, and he told me that he and John Lasseter spent about two months just observing things at Disney, after they took over as heads of the Disney Animation Studio, and he said the observational period was really important. How would you square the circle between that sort of observation and what you've seen in your research?

Thomas Meakin: I think it's a great question, Allen. It corresponds with what we're finding. First, the data supports the trend and, on average, over the course of their tenure, external CEOs have a year less in office than their internal counterparts. We haven't delved into it, but to some extent, the suggestion in the data is that external CEOs sometimes pay for being too bold in the wrong context. Second, this point on timing: we're advocating bold action, and that means making aggressive moves, and it means doing them relatively quickly. But we're not talking in terms of weeks here. We looked at the average leaving rate within our data set—the propensity of CEOs to leave in any given year, depending on how they were doing relative to their industry—and there was an inflection point in year three. CEOs who were underperforming in their industry were twice as likely to leave in year three as they were in their first or their second year. What this demonstrates is that boards and shareholders are understanding. They expect performance, they expect action that gives results, but they don't expect it immediately. So, be bold, be aggressive, move quickly, but take the time to make sure the actions you're choosing to do are the right ones, because your board and your shareholders will give you that.

Allen Webb: So, don't act fast, but when you do act, act.

Thomas Meakin: I'll just share a personal example. Over the last nine months, I've been part of a McKinsey team that's supporting a new CEO in a transition. That individual spent almost four months embedding into the role, starting out with a seat on the advisory board; spending initially one day a week on the ground, which then grew to two, to three, to four; understanding the business; understanding the personalities; understanding some of the politics. He's now been in the role for five months. The business is trending at twice its original business plan, and, I think to a very significant extent, this is because the new CEO has made purposeful choices that are grounded in a detailed understanding of the business, how it makes money, and how it works internally. He is leading the organization through a transition from a B2B company to a B2C company, and as you might expect, this necessitates a whole bunch of changes and new things, in terms of customer segments, in terms of geographies, in terms of organizational capabilities. The list of things that he could have done is bewilderingly long, but that time invested early has meant that he's prioritized, and I think we're now seeing the benefits of that prioritization.

Allen Webb: Michael, do you have any anecdotes or experiences that help clarify some of the things you found in your research?

Michael Birshan: Sure. We talked about the performance of outsider chief executives versus insider chief executives and how, actually, in many ways the best is someone who marries the two—what Joseph Bower of Harvard Business School calls the inside-outside leaders. I'll tell you of two chief-executive transitions that I know very well. In one situation, a long-standing leader in the company, who had previously been in a private-equity business, took over. Because of that private-equity lens, he used to talk to his management team about what would happen if the company got taken over by private equity: What would they do? I'm going to make sure that we do it earlier and first. So organizational redesign, geographic contraction, divestment of some businesses, strategic review, management reshuffle—a series of moves freed up a lot of cash for some transformational M&A, all within the first two years of this chief executive's tenure. That CEO is known within the industry as someone who has really driven top performance.

Another similar situation involves a long-standing executive within the company, but again in a company that was known for lifers. This executive had previously worked outside the industry and then had been in the organization for 15 or so years. He steps up to the top role and, again, moves with pace and aggression. In his circumstance, there was a costreduction program, a strategic review, management reshuffle, geographic contraction, divestment of some businesses, and, again, being the leading performer in the industry. Those are two examples of chief executives with the insider skills of knowing how to make change really happen and really happen quickly, but with the boldness of outsiders, and they're the top-performing chief executives in their industries over the last few years.

Allen Webb: Can you describe how that blending works and how it makes it easier to do some of the tough moves?

Thomas Meakin: In my experience, the tricks that most great CEOs use to do it well are often behavioral and communicative. One example that strikes me was supporting a technology, media, and telecoms business in Europe. We were trying to move the organizational structure of the business from a historical classic telco model, where the marketing function controls quite a lot of other subfunctions, including product design and customer life-cycle management, and move it toward an organizational model that was much more suited to building new products and new software-based products. It was a big shift. The new CEO spent a long time understanding the individuals who would be critical to making that organizational transformation work. He knew he was going to do it relatively soon. He built trust-based relationships with the individuals involved but then kept referring to his external knowledge—he'd been head of a digital lifestyle business previously—in giving a justification for the organizational change he was trying to make. He combined an understanding of organizational politics and dynamics with an ability to reference and communicate an external industry. And those two things together made what would have otherwise been a tortuous transformation that we probably would've stopped halfway through into one that worked in the end.

Allen Webb: Well, maybe that's a good note to end on. Thank you very much, both of you, for your time today. This is fascinating.

Michael Birshan: Thanks, Allen.

Thomas Meakin: Thanks, Allen.

Michael Birshan is partner based in McKinsey's London office, where **Thomas Meakin** is an associate partner. **Allen Webb,** editor in chief of *McKinsey Quarterly*, is based in the Seattle office.