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Why Boards Go Awry in Their Hiring Decisions

Research shows the costly effects of bias in failed executive-selection processes

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By Patrick M. Wright and Donald J. Schepker

Choosing C-suite executives is a big responsibility that boards and chief executives take very seriously.

So why do so many boards and leadership teams make bad decisions?

Research has shown that as many as 35% of CEO departures are forced exits. In a recent survey of roughly 180 chief human-resources officers, more than half said they had observed at least one failed C-suite appointment over the past five years, and some estimated that as many as 40% of all C-suite-level hires during their tenures had failed.

Consider the financial impact of those failures. We often see payouts in the $60 million to $100 million range to release a failed CEO. In addition, our research has found that direct costs (salary, benefits, bonus, severance, etc.) can reach $20 million when a new C-suite executive plunges to earth. If indirect costs are included (missed business opportunities, suboptimal operations, etc.), the impact of a CEO stumble can cost a firm more than 30% of its stock price, while other C-suite mistakes can shave as much as 1% off share value.

Boards and business leaders know the risks. But again and again, C-suite candidates are chosen despite shortcomings the group itself has identified, candidates with better qualifications and even a board's own vocalized misgivings.

The reason, our research suggests: common decision biases.

Some are well known, like confirmation bias, in which decision makers forge ahead in directions that best fit their preconceived notions about a problem or issue. Other types are less recognized.

Here are common biases that can lead to dysfunctional decision making, and what boards and leadership teams can do to avoid such pitfalls.

In-group bias

The problem of in-group bias often crops up at the very start of a selection process. A board and executive team made up of white males, for example, can put together, without consciously meaning to, a slate of candidates of predominantly white males.

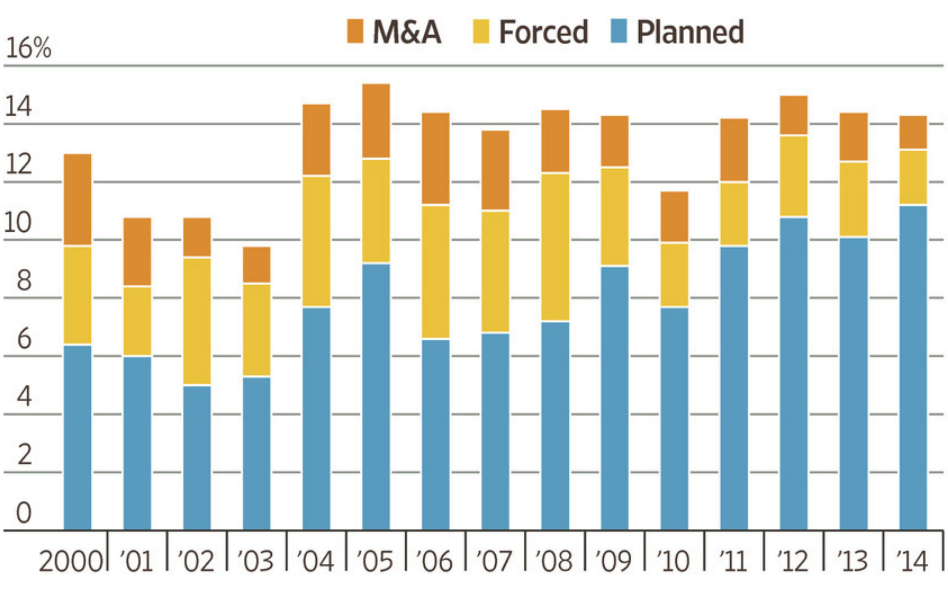
It's considered part of human nature to favor those who are like ourselves. But management studies have repeatedly shown there can be advantages to having different ethnicities and backgrounds represented among a company's top decision makers.

In an annual survey of chief HR officers for the past six years by the Center for Executive Succession, part of the University of South Carolina's Darla Moore School of Business, HR chiefs report frequently lobbying with boards to develop a diverse slate of candidates for every C-suite position. But the chiefs also report usually getting shot down, because, some have said in interviews, board members say they know who the right slate of candidates are.

The solution: *Boards and executive [to save a line] leadership teams should require slates of diverse candidates for every C-suite hire.*

Change at the Top

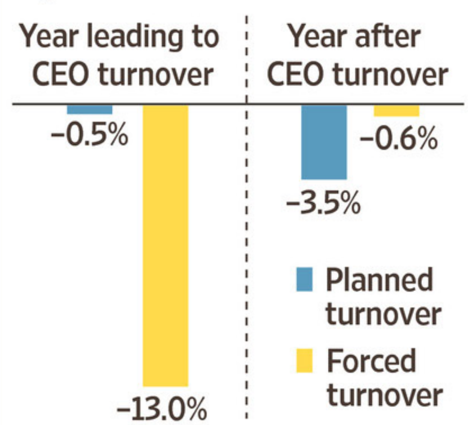
CEO turnover rates at the world's 2,500 largest public companies



Source: Strategy&

High Cost

Median total shareholder returns at companies undergoing a CEO change, compared with a relevant regional stock index



Note: Based on data from 2011-2013

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Repetition bias and the bandwagon effect

As a slate of candidates is reduced, two biases can work together to lead to poor decisions. Repetition bias happens when individuals or groups begin to believe the most-repeated messages rather than the most valid ones.

For instance, if a CEO continually brings his or her favorite candidate before the board and repeatedly suggests this candidate is best, the board may begin to believe it.

The bandwagon effect can then occur, because as a few board members get on board with the decision suggested by the CEO, each successive board member begins to fall in line with the rest of the group.

The solution: *While CEOs need to be able to choose their teams, boards should limit the CEO's role and influence in choosing succession candidates.*

Escalation of commitment

This bias tends to happen toward the end of a selection process. In such cases, committee memberrs presented with information that challenges their assumptions late in the game will stick with the candidate they already favor, based on the belief that they are too far along in the process to stop and re-evaluate.

The problem here is the committee tends to lose sight of the importance of each small decision and instead focuses too much on the goal.

For instance, a big multinational had searched for a successor to lead one of its business lines. It identified an outsider with impressive accomplishments over his career. The interviews had gone well, and the board was set to extend an offer. Then it received a letter from someone at the candidate's present company. The letter detailed a number of his faults and argued that the committee would make a huge mistake by hiring him.

The firm extended the offer anyway. One board member stated, "We can't pull the offer at this stage." Within six months, however, the CEO, board and members of the executive team reached consensus that the executive in question never should have been hired, for reasons that were consistent with the allegations made in the warning letter, according to the HR chief.

The solution: *Never rush to a decision. Boards and leadership teams shouldn't overlook the importance of careful evaluation at every stage of the selection process, including the final vote.*

Confirmation bias

While escalation of commitment happens toward the end of the process, confirmation bias happens at any stage: an individual or group ignores information that would cause them to change their opinion. It can be like a halo effect, when a smooth presenter keeps a board from recognizing any negative information.

One firm's board had identified a favorite internal candidate to lead one of their larger businesses. However, the individual's most recent 360-degree appraisal had revealed leadership-style defects that called into question his appropriateness for the new role.

The board reverted to a 360-review from five years earlier, in which the candidate got good results, and ignored the negative data. Within months, the error of this promotion became apparent to all, for the very reasons pointed to in the recent 360.

The solution: *A devil's advocate can force boards not to ignore negative information. In addition, each board member should have to publicly state the risk factors or weaknesses of every candidate.*

Board members and leadership teams must keep the selection process as objective as possible, focusing on as many facts and as much data as can be obtained. Performance histories and presentations provide only a limited glimpse into a candidate's potential to handle a larger and more complex role. They also provide opportunities for subjective interpretation to enter the process.

This suggests a much greater need to integrate formal assessment tools into executive-succession processes.

Finally, it's important to note that decision biases stem from neither evil intent nor insufficient attention. Rather, they are the natural product of human nature, and people's limited information-processing capabilities. Being aware of these limitations can help decision makers avoid costly succession mistakes.

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