

# Act II for CEOs

## Scripting a successful tenure

by **David Nadler**

Over the years, we've all observed a precipitous decline in the average tenure of CEOs—not just in the United States, but in Western Europe as well. The 20-year tenure so common during the reign of the Imperial CEOs had dropped to an average 10-year term by the turn of the century and now, depending upon whom you believe, averages anywhere between four and seven years.

All sorts of factors have been cited—the growing complexity of the CEO job, more aggressive investors with higher expectations and less patience, and empowered but nervous boards that are more likely to pull the trigger at the first sign of trouble. All are valid, but they don't get below the surface to describe a phenomenon we believe accounts for an increasing number of CEO failures. Simply put, the pace and intensity of changing business conditions are forcing many CEOs to turn their backs on the very behaviors and leadership strategies that led to their success, or face the prospect of almost inevitable failure.

Many non-routine departures follow a similar script: A successor is recruited—someone thought to be better equipped to fix what the last CEO couldn't, or wouldn't. The new leader arrives with a mandate to change course, and the board places its confidence in him or her because of the present dilemma's similarity to a previous challenge he or she dealt with successfully.

Research indicates that leaders succeed when the skills demanded in their new positions directly draw upon their professional backgrounds and experiences. But familiar problems are inevitably succeeded by less familiar ones, and the experiences, skills, and temperament that yielded triumph in Act I can turn out to be unequal to Act II's difficulties. In fact, the approaches that worked so brilliantly in Act I may be the very opposite of what is needed to bring Act II to a happy resolution.

As the drama unfolds, the CEO has four choices: He can refuse to change, in which case he will be replaced; he can realize that the next act requires new skills and learn them; he can downsize or circumscribe his role to compensate for his deficiencies; or he can line up a qualified successor.

All but the first option are reasonable responses to the challenges presented in the second acts of most CEOs' tenures. And all but the first require a power of observation, a propensity for introspection, and a strain of humility that are quite rare in the ranks of the very people who need those qualities most. Examples of CEOs who exemplify each alternative follow.

## Four Versions of Act II

### 1. Remake your company but lose your place.

Carly Fiorina was brought in as CEO at Hewlett-Packard to address a specific set of problems because of her past success in dealing with similar ones. HP had become stodgy, inbred, bureaucratic, uncompetitive, and demoralized. Its last groundbreaking innovation, the ink-jet printer, had been introduced 15 years earlier, in 1984, and quarterly growth was almost nonexistent. Competitors threatened to encroach on every segment of HP's business. So the board sought a dynamic, first-class communicator who could revive morale, restart the innovation engine, cut through the bureaucracy, and justify the company's reputation.

Fiorina, who had done these things before as president of Lucent's Global Service Provider Business, filled the bill. She set out to market her vision for HP by making appearances at high-profile events, courting media attention, meeting with HP manag-

Rapidly changing business conditions eventually force CEOs to abandon their current leadership strategies and to embrace a new approach—or fail.

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ers, and becoming the public face of the company in its commercials and ads.

She laid off thousands of people and consolidated product groups to reduce redundancies and speed decision making. But only a major acquisition, she concluded, could disrupt entrenched routines and catapult HP into a commanding lead in the personal computer industry. She overrode a boardroom minority that objected to a merger with Compaq, and ignored those who pointed out that mergers of large high-tech companies had never worked out.

Today, even her detractors admit that the Compaq acquisition is working. But integrating two organizations and boosting operating performance in the core businesses require very different skills from developing a vision, embodying it, communicating it, and driving it through—Fiorina's proven strengths. Her continued public exposure led to accusations that she was an incorrigible publicity hound. Reluctance to delegate caused conflict with the board, which lost confidence in her, and led to her departure in 2005.

### 2. Remake your company, then yourself.

In 2003, as Stan O'Neal finished his first year as the CEO of Merrill Lynch, he sensed it was time for a change despite his tremendous success. Six weeks after being named president, he was regrouping the firm following the terrorist attacks of September 11, 2001, which killed three employees and forced the company to evacuate its headquarters. Additionally, Merrill Lynch was still feeling the effects of the bursting of the technology bubble, and it would soon be hit with a wave of negative headlines about the Wall Street research scandal. O'Neal made painful and unpopular decisions that

would be criticized by some within Merrill Lynch and second-guessed from the sidelines.

Between 2001 and 2003, he resized and reshaped the firm, cutting costs to cope with lower revenue, reengineering parts of the business to diversify revenue streams and neutralize the roller-coaster highs and lows of debt and equity trading, and reining in failed expansion plans.

O'Neal knew he had to rethink the firm's entire business model and challenge the "Mother Merrill" culture that had become more maternalistic than performance based. He also had to improve the morale of a shaken workforce and retain the attributes of the iconic franchise.

By the summer of 2003, O'Neal's efforts had paid off, with Merrill Lynch posting the best first-half results in its nearly century-long history. He began to think about what he would need to do to ensure that Merrill's future leaders would not have to face similar problems. He realized that new challenges would require Merrill's executives, himself included, to provide a substantially new kind of leadership.

Working with an outside consultant and his senior management team, the Merrill Lynch Leadership Model was created to clarify what they expected of themselves and other leaders at the firm. The model focuses on four critical areas: strategic thinking, business results, people leadership, and personal effectiveness.

The top 11 leaders (including O'Neal), then the next 200, then the next 1,000, received feedback and coaching. Changes were made in performance evaluation, rewards, talent reviews, and other mechanisms to support the new model of leadership. Objective measures reveal that Merrill's culture, which had been homogeneous, lenient, and clubby, has shifted significantly, becoming merit-based, rigorous, and diverse.

### **3. Recognize and respect your limitations.**

Larry Page and Sergey Brin founded Google when they were doctoral candidates at Stanford. The Internet search engine they invented enabled their company to be one of the few healthy survivors of the dot-com crash. As their background might suggest, the founders' strong suit is writing computer code. But their ambitions for Google go well beyond spurring technical refinements of its core tech-

## **Implications for the Board**

The near inevitability that a new CEO will face an Act II that puts his or her skills and assumptions to a severe test places special responsibility in the hands of boards of directors. This advice is addressed to them.

- In succession and selection, beware of stylized leaders or one-trick ponies who seem to have succeeded in one kind of situation but have had limited exposure to a range of leadership challenges. Look for evidence that the individual has developed or could adopt more than one leadership approach.
- Pay attention to the possible leading indicators of CEO ineffectiveness, such as failure to deliver on promises, excessive rationalization of failures, departures of valued executives, or a CEO who seems to be out of touch with his organization or even his

own team. The board should collect data with an eye toward determining the CEO's ongoing effectiveness. The board's sense of his progress should be shared with the CEO and the company's other leaders.

- Recognize that the board has a role to play in mentoring and coaching the CEO. Too often, the board takes a hands-off approach until it becomes apparent that the CEO is faltering.
- When faced with a crisis, recognize that you may need to think about a two-stage succession process. Consider bringing in a CEO specifically to handle the immediate problems. Make clear that once the crisis has been resolved, you may look for another CEO better suited to dealing with the next round of issues.

nology. Google now offers satellite mapping, digitalized libraries, and its own e-mail service, and its search capabilities extend to e-mail databases and company intranets. Although Page and Brin were committed to staying with the company, they knew they weren't professional managers or marketers or masters of strategy, so in 2001 they brought in a "grown-up," Eric Schmidt, to operate the company.

Schmidt had been the chairman and CEO of Novell for four years, and before that he was the chief technology officer at Sun Microsystems, where he led the development of Java. He is a skilled big-company executive, a seasoned marketer, and a renowned technology expert. With Schmidt as CEO, Page as president for products, and Brin as president for technology, the company has flourished beyond almost anyone's expectations. It's one of the few examples of technology-oriented founders making a smooth handoff to a professional manager.

#### **4. Remake your company, then move on.**

In 1995, Ken Freeman was named chairman and CEO of Corning Clinical Labs, the ailing medical testing business soon to be spun off from Corning. Freeman had been a Corning "lifer," rising through the financial side to become controller while still in his early 40s, then moving through a variety of roles, among them running the company's television-glass business and serving as CFO.

Freeman found the labs business in shambles. Receivables sat on the books interminably; cash flow was plummeting at an alarming pace; questionable lab results and billing practices had made the company (along with others in the industry) a target of government investigations. Freeman's drastic mandate was not to rescue the business but to get it ready to be sold. When no credible buyer stepped forward, Corning was forced to spin off the clinical labs as an independent public company with Freeman as its chairman and CEO.

Freeman quickly installed a rigorous quality process, assembled a new board, and generally pulled the company together. Having created stability, he embarked on an expansion program that culminated in the acquisition of the lab's largest com-

## Boards can help develop more adaptive C-suite executives by rotating promising executives through various locations, functions, and businesses.

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petitor, SmithKline Beecham Clinical Laboratories. When the dust settled, the now renamed Quest Diagnostics was the industry leader in size, geographic reach, market share, and quality. Its stock price soared. Then, in 1999, with Quest still gathering momentum, Freeman worked with the board to put in place an orderly succession. In 2003, at the still youthful age of 53, Freeman passed the baton to Surya Mohapatra and left the company.

Why, unlike Fiorina, did Freeman leave before he had to? Reflecting on his decision later, Freeman observed that the company's future growth would have to be organic. A deep understanding of medical technology, which Mohapatra possessed and Freeman lacked, was going to be a more crucial qualification for leading Quest than a flair for turnaround situations or a gift for deal making.

Freeman felt most alive in the high-pressure situations of crisis and M&A, so he went looking for a new arena where he could find excitement and success. Today he is with KKR, engineering turnarounds at companies such as Masonite International.

### **Surmounting Obstacles**

As predictably as in a Shakespeare play, a successful CEO's Act I will end, and a second act will begin, sometimes imperceptibly. It usually happens before the first two years are up. A career-testing ordeal arose after two years in O'Neal's case, three years in Page and Brin's, and five years in Fiorina's.

Why do so many high performers meet their end when Act II begins? First, some CEOs are simply oblivious to the shift in its early stages. The extraordinary commitment they must make to solving one

set of problems, and their tendency to attack those aspects most likely to yield to their proven methods, somehow blind them to less familiar realities, as well as to the new leadership approaches that are required. Second, some CEOs sense the shift but fail to understand how much damage they can cause by sticking to their original approaches. CEOs are notoriously poor observers of their own behavior, and they rarely notice its unintended consequences or invite feedback. Third, some recognize the new circumstances and thus the need for a change in their modes of leadership but are incapable of transforming themselves. Finally, some don't change in Act II because they don't want to.

Achieving a dramatic change in leadership style is difficult for anyone, but it's particularly hard for successful people in their fifth or sixth decade. Personality and character aside, such people have

developed systems for leading, so to speak, that they can't bring themselves to jettison.

Another way of looking at this phenomenon is that these leaders' well-worn management techniques have become inseparable from their prevailing views of themselves.

Psychology and learned behavior, reinforced by experience, are only half the story, however. The limitations in executives' cognitive abilities also have a role to play in CEOs' Act II reversals. A longitudinal study published by Andrew D. Henderson, Danny Miller, and Donald C. Hambrick in May 2006 compared the tenures of 98 CEOs in branded foods, an industry that the researchers describe as comparatively stable, with 228 CEOs in computers. The food companies' performance tended to improve over the course of the CEO's tenure; in computers,

## Responding and Adapting in Four Steps

Despite the personal and professional limitations that affect executives' ability to adapt, there are four essential steps executives can take to discern that they have entered new territory and to respond accordingly.

**1. Recognition.** Evidence that your leadership style and approach are no longer working can take several forms. You may notice that people aren't responding as they once did to your speeches, especially those in which you lay out your vision for the next two or three or five years, and that your initiatives are faltering. You may also find yourself clashing with your team or with your board. You may start to feel fatigued and emotionally disengaged from your work, which has started to seem like a job rather than a calling. While none of the above by itself would be proof positive that the ground has shifted, an accumulation of these factors would be strongly indicative.

**2. Acceptance.** For a successful, confident, and assertive leader, it is tempting to see failure as the result of others' negligence or mistakes and to believe that poor performance merely calls for redoubled courage and persistence. But such beliefs are often self-deceiving and even delusional. It is therefore important that

leaders rely on more than just their own impressions and seek advice from other sources, such as the full board, selected directors, or, as in O'Neal's case, outside consultants.

**3. Analysis and understanding.** Once you recognize that Act II has arrived and that it requires a new type of leadership, the next step is to understand the nature of the shift. What would an Act II of your own making look like, and what are its implications for your leadership approach? An objective evaluation is often beneficial.

**4. Decision and action.** CEOs employ a number of different strategies at this stage:

*Personal change.* In some cases, the CEO is able to step back, understand the requirements of Act II, and adjust his approach accordingly, as O'Neal did at Merrill Lynch. However, this modest-sounding goal requires a rare ability to reflect on one's own behavior and a willingness to reveal one's weaknesses and admit shortcomings. Then the leader must take on the task of self-transformation with all the determination and tenacity he formerly directed at pushing the organization forward. A CEO who can do that will no longer be the captive of strategies that have outlived their usefulness.

performance tended to peak early and diminish steadily thereafter. The authors' hypothesis is that every CEO comes to the job with a "relatively fixed" approach—a view of the world and a matching set of skills. The more dynamic the business environment, the faster those world views and abilities become mismatched to present realities, both competitive and organizational, and "it will be the rare executive who can greatly transform his or her mind-set, aptitudes, and skills."

As the researchers suggest, a senior executive who has built her career on being the most effective mass producer of the lowest-cost products would find it extremely difficult to adopt a strategy based on providing luxury offerings. She would be hampered by her mental habits, her values, her understanding of and interest in particular kinds of customers, and her entrenched notions of what works.

Executives in the publishing industry are experiencing those pains right now. Despite their grand visions of migrating content from print to digital platforms, the majority of longtime print executives are finding it difficult to make the wrenching decisions required to facilitate the transition, even in the face of increasing pressure to do so.

Companies that successfully identify and develop talent recognize that stylized and otherwise limited managers can be effective if matched to the right situations. They also recognize that people often need to be moved laterally when situations change or when it becomes clear that an executive has been put in the wrong position. But there is no lateral move for a CEO. When a chief executive is inflexible or unable to see a change in circumstances, the board must take actions that are inherently unpleasant and disruptive.

*Structural change.* Page and Brin's handoff to Schmidt at Google can be seen as a classic case of redesigning the management structure to complement the strengths of the top people. HP's board appears to have attempted the same thing with Fiorina. The board recognized the need for a change in leadership style and initially proposed that Fiorina be put in a structure that would devolve some of her duties to subordinates better suited to overseeing day-to-day management. Fiorina, by most reports, rejected this approach.

*Accelerated succession.* Finally, a leader can acknowledge that the shift has begun and that it will call for a different chief executive. Such a decision requires a high degree of self- and situational awareness. Many CEOs suffer from a misplaced sense of obligation to stick it out and complete the mission, even when signs are plentiful that hanging around would actually imperil it.

## Responding and adapting to change in Act II

| 1. Recognition   | 2. Acceptance   | 3. Analysis, understanding   | 4. Decision, action  |
|--|---|--|--|
| Evidence your leadership style and approach are no longer working can take many forms  | It could be self-deceiving to blame failure on others or to try to fix things by being persistent   | It's important to understand the nature of the shift that requires a new type of leadership  | A number of strategies can be effective  |
| <ul style="list-style-type: none"> <li>• People aren't responding to your speeches</li> <li>• Your initiatives are faltering</li> <li>• You clash with your team or the board</li> <li>• You feel fatigued and emotionally disengaged</li> </ul> | <ul style="list-style-type: none"> <li>• Seek advice from others, including the full board, selected directors, or outside consultants</li> </ul> | <ul style="list-style-type: none"> <li>• What would a second act of your making look like</li> <li>• What are the implications of your vision for your leadership approach</li> <li>• An objective evaluation can be beneficial</li> </ul> | <ul style="list-style-type: none"> <li>• Personal change: reflect on your behavior and admit shortcomings, then embark on self-transformation</li> <li>• Structural change: redesign the management structure to complement strengths of the top people</li> <li>• Accelerated succession: acknowledge that a different chief executive is needed</li> </ul> |

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A smart board and a thorough search process will often turn up the right person to solve a company's immediate problems. But today's marketplace, in which buying patterns can suddenly shift and new technologies can materialize out of nowhere, will surely test a new CEO before long.

Removing a maladaptive CEO before her time is messy and traumatizing for all concerned, including the ranks of employees. Consequently, boards have a duty to choose and cultivate leaders who can negotiate the transition from the first act to the second and, for that matter, from the second to the third, and so on. Moreover, boards can make sure that up-and-coming executives develop an

awareness of, and receive training for, Act II transitions, so that if and when the individuals get to the C-suite, they are potentially more adaptive. Boards can do this by seeing to it that promising executives rotate through various locations, functions, and businesses; after all, divisions and subsidiaries present their top managers with Act IIs that are similar to, if less wrenching than, the crises that face corporate CEOs.

Such an approach expresses the ideal. In reality, there's a scarcity of CEOs who can repeatedly refashion themselves. So the board must respect the limitations of the mere mortal who has served the company well, if only for a few years. By the same token, proud CEOs must come to recognize when their time has passed. ❖

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This article was adapted from David Nadler's article "The CEO's Second Act" in *Harvard Business Review*, published in January, 2007.