THE STERLING REPORT

Executive Transitions: The Six Avoidable Paths to Failure*

*Hint: Recruiting is not one of them!

APRIL | 2019

EDITION | 01

Note: The focus of this document is primarily on founders and long-term CEOs – those in place 10+ years. Those are the transitions that present the biggest blind spots and risk factors, although these considerations are relevant for all organizations.

When it comes to Executive Transitions, focusing only on recruiting is an expensive and potentially disastrous blind spot. The reality is that these critical transitions require in-depth advance planning across multiple dimensions of the organization. In this edition of **The Sterling Report**, we signpost the six paths that can lead to big-scale transition failure, and the risks and opportunities that lie hidden in plain sight.

Typically, Boards are ill prepared to anticipate or navigate costly hazards until it is too late. Funders are in a unique position to protect their investments, recognize these patterns across their portfolio, and play an important role in educating, raising capacity, and supporting Boards to avoid these risks and choose a path that leads to success.

Emily Sterling collaborated with Vista Global to conduct a study of nonprofit CEOs and Board Chairs, exploring their attitudes and behaviors related to succession planning (*Proactively Plan for the Inevitable: A Guide to Leadership Transition and Succession*). In that study, we learned that:

- 62% of organizations have no documented succession plan
- 56% of Board chairs said "The CEO doesn't plan to leave for a long time"; 40% of CEOs plan to leave within two years.
- 50% of organizations say lack of funding is a factor in preventing them from proactively addressing transition and succession planning.

Failure Path 1

The Hidden Liability on the Balance Sheet

Many founders and long-term executives, in particular, draw a salary well below the market cost to replace them. This is frequently due to the lack of annual evaluations and compensation reviews by the Board; and just as often, that person feels that if they take an increase in salary they are being greedy, diverting funds from the mission that drove them to stay there for decades, or they will just have to raise it so they are not motivated to increase it. We have seen many instances where the cost to replace the CEO in the market is two to three times the current salary.

In some cases, we have worked with clients where the founder worked for decades "for free", which seems magnanimous but actually puts the organization at huge risk financially as it approaches an unseen cliff of increased costs and mission/administration ratios. In addition to the huge hit to fund the CEO salary, generally the staff salaries are pegged accordingly, and they are much less excited to stay at their below-market salaries when a new CEO comes in at a significantly higher compensation. Thus, the financial cliff is both massive and immediate.

Failure Path 2

Hidden Roles in the Org Chart

This is another type of hidden financial liability. Frequently a founder or long-term executive is filling multiple roles because they know everything about the organization and are very efficient. This is an unseen "subsidy" that comes to light in the new recruiting – the need to replace the CEO with an additional two or three roles (head of programs, Additional research by others in the sector supports our findings, indicating that 10-20% of executives in the sector will need to be replaced each year. [see *Sources*]

As a funder, consider your grantee portfolio (or as a national nonprofit, your affiliates) – is one-in-five every year ready to navigate a transition successfully, and continue their mission results at the same or higher level?

In the three years since our study, during which we have engaged with hundreds more CEOs and Board members, we unfortunately have not seen evidence that this pattern is changing. There are many disincentives to a nonprofit Board proactively tackling long-term succession planning. Some of these include:

- **Competing priorities and a drive for mission results over infrastructure investments.** Thoughtful transition planning requires time and resources to explore all the facets and nuances, and then to take a comprehensive approach.
- **"Head in the sand".** Board members prefer not to think about such a challenging topic and they hope it will not happen while they are on the Board.
- **Lack of understanding.** Most Board members and executives have zero or limited experience with CEO transitions and their many complexities. They don't know what they don't know, and don't see the risks.

As a result, we see most nonprofit Boards engaging reactively when their CEO is departing. Their primary response is to hire a recruiter. While this is an important piece of the puzzle, it fails to address the volume, nuance, and complexity of factors that actually drive the greatest risks to an organization's mission delivery and even survival in some cases. Anyone working in the sector for more than a brief period has heard of, or been a part of, chief financial officer, and chief operations officer are the most common). The scope and breadth the founder can handle is just not realistic for an incoming replacement. In addition to a big financial impact, it will take the organization some time to assess, recruit, and onboard these new executives, resulting in significant productivity lags and frequently a reputation hit.

Failure Path 3
Hidden Connective Tissue Gaps

It is very common for a founder or long-term executive to have 10-15 direct reports. The work is hugely distributed and siloed, with the CEO providing the only "big picture" view and connectivity among the activities, and also holding all the key relationships. With no other staff seeing the forest for the trees, and the Board relying too heavily on the founder, this creates a serious "house of cards" moment for an organization. This also relates to Failure Paths 1 and 2 – as no new CEO can manage that number of direct reports, and needs to hire c-level leaders to compensate.

Failure Path 4
Hidden Governance Leadership Risk

We have seen dozens of instances where the founder or long-term executive essentially runs the Board – setting agendas, running committees, leading Board conversations, coming with rubber-stamp recommendations. Virtually none of these Boards has regular executive sessions or a culture of strategic inquiry. This leaves them without a real understanding of the organization, an inability to properly recruit or support or hold the new CEO accountable, and a deep gap in understanding how to govern in this new environment. The Board has no

the stories of transitions going "off the rails" – inability to attract good candidates, financial crises, other staff abandoning ship, donors disengaging, the wrong "fit" and a quick departure of the new hire, internal conflict, and a host of other misadventures that could have been prevented.

The transition of a CEO is like an organ transplant – and it gets more complicated with longer tenures. It's not a simple matter of securing a donor organ and popping it into place cleanly like a missing puzzle piece. There are a number of interdependent systems and connections to consider, understand, map out, and address. And there are important interventions that must happen before and after the transplant in order to ensure success. There are common risks to mitigate against, and major ramifications for failing to do so.

Over the past 30 years of advising nonprofit Boards and funders, we have seen a lot. **In this report, we point out some of the most common Failure Paths and missteps that occur in a recruiting-only approach to a transition.**

Because most nonprofits are neither equipped nor even understand the importance of addressing these issues, **Funders need to play a role in raising the capacity** of the sector in order to protect their grantee investments and the positive trajectory of the work:

1. Support those tackling transitions in the short term – currently or within a few months. These organizations are at the highest risk and are experiencing the highest stress. Their sense of urgency amplifies the blind spots and reactive decisions lead to poor decisions. They lack an understanding of the full picture of what they need to navigate, and even if they get a glimpse of it, they are quickly overwhelmed by the firehose of considerations and challenges to navigate all at once.
2. Encourage the others to engage in comprehensive and thoughtful assessments and planning which will allow them

experience in establishing a new kind of partnership, taking ownership, providing accountability, informing strategy, leading a CEO evaluation, or setting joint goals with the CEO. The experience is something like a teen's first year in college with a lot more responsibility and authority but a lack of experience to navigate it well.

Failure Path 5
Hidden Financial Bombs

In addition to the financial liabilities of new market salaries and adding new senior management positions, there are other frequent financial challenges and cash flow that Boards don't always anticipate. A major one is the sudden gap in expected funding as many donors and contracts decide to "wait and see." Boards also generally don't anticipate the costs of recruiting, relocation and the overall loss of momentum in fundraising, earned income, and program delivery that can result from a transition – and be significantly exacerbated by a lengthy or very problematic transition.

Many organizations have few cash reserves and Boards are simply not prepared for the impact on the financials. In one case the interim CEO (an existing staff member) hid the cash flow issues so successfully – because he feared that bringing these issues to the Board would reflect poorly on him – that when the new CEO opened her desk drawer on the first day she found a stack of checks cut but never mailed, and an immediate $500K deficit.

Failure Path 6
Not Identifying the Real Issues

This is a classic case of focusing on symptoms vs. causes. We have had experience with too many nonprofits that have had four CEOs in five years. The

to be proactive and prepared for an eventual (and inevitable) transition.

Funders invest in nonprofits in order to enable their vision for change in the world. They want to protect the investments they have made in their portfolio, as well as the positive momentum of the work. Funders are in a unique position to support their grantees to address the hidden risks of both immediate and eventual transitions. Funders can accomplish this by proactively addressing the topic with their grantees; providing resources for greater understanding; and supporting individual grantees and cohorts through capacity building and expert guidance.

Sources:

1. *Leadership New England, "Essential Shifts for a Thriving Nonprofit Sector" (2015).*
2. *Compasspoint Nonprofit Services and Raffa, "The Evolution of Executive Transition and Allied Practices" (2017)*
3. *David Allen, SHRM Foundation, "Retaining Talent: A Guide to Analyzing and Manager Employee Turnover (2008)*
4. *Penelope Burk, Cygnus Applied Research, "Donor-Centered Leadership" (2013)*

STERLING CONSULTING

emily@emilysterling.org
(650) 591 - 4155
www.emilysterling.org

Board continues to point to issues in the recruiting – "We just didn't get the right fit; the person couldn't deliver what they promised in the interviews; we didn't have enough good candidates" – instead of the underlying causes of the turnover – causes such as lack of relevancy or clear strategy, flawed or stressed financial model, serious culture or talent issues, loss of credibility, lack of clear priorities, poor governance practices, and more. All of which could be addressed before the recruiting in order to prevent repeat turnover.

Quotes + Data

"63% of executives described their incoming experience as "somewhat" or "very challenging." "60% of incoming leaders discovered "weak" or "in crisis" organizations." (Compasspoint/Raffa, 2017)

"The transaction costs alone of finding and attracting a new employee, particularly at the senior level, can be as high as half of their annual salary. But the costs to an organization in productivity, fundraising, and distraction (as members of the Board and senior team turn to recruiting and onboarding critical staff positions), can add up to tens or even hundreds of thousands of dollars more." (David Allen, SHRM Foundation, 2008)

"One study suggests that losing a star performer in a senior development role ≈ costs nine times their annual salary to replace." [Is your CEO the primary fundraiser for your organization?] (Penelope Burk, Donor-Centered Leadership, Cygnus Applied Research, 2013)

THE

STERLING

REPORT

© 2019 The Sterling Report.

All rights reserved. No part of this publication may be reproduced, distributed, or transmitted in any form or by any means without the prior written permission of the publisher

www.emilysterling.org

STERLING CONSULTING

emily@emilysterling.org