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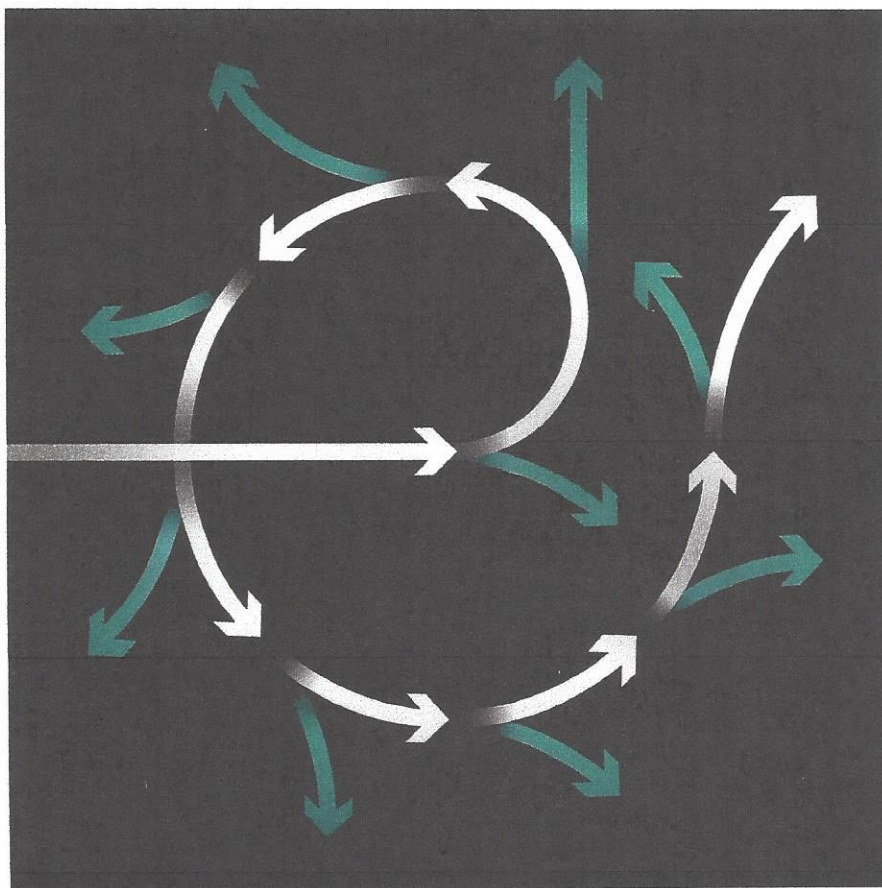
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# The CEO Life Cycle

A study of performance over time



**T**HE EXECUTIVES WHO appear on *Harvard Business Review's* 2019 list of best-performing CEOs in the world show remarkable longevity in their roles: The average honoree has been CEO for 15 years, more than double the S&P 500 average in 2017 of 7.2 years. All these people have created tremendous value during their careers—but like most other CEOs, many have experienced short-term ebbs and flows in performance. For boards, that can create a quandary: How to tell when a CEO is suffering from a negative blip versus a longer-term problem, and how to react? These CEOs' stellar career numbers can create another issue: How does a board know when it's time for a high-achieving leader to step down?

Very little data exists on how CEOs tend to perform over time; CEOs, directors, and investors often fill the knowledge vacuum with anecdotes, assumptions, and rules of thumb. For instance, when we asked CEOs about the ideal tenure for the role, many mentioned the widely touted seven-year average.

When we surveyed directors, they said that CEOs generally should leave the job after 9.5 years—a point at which, many believe, performance typically plateaus. Why these expectations? No one has a compelling or evidence-based answer. They are simply conventional wisdom.

To better understand the typical course of value creation over a leader's tenure, we launched what we call the CEO Life Cycle Project. Our team of researchers tracked year-by-year financial performance over the complete tenures of 747 S&P 500 chief executives and conducted 41 in-depth interviews with CEOs and directors about their experiences. (See the sidebar "Our Methodology.") The study reveals a surprising pattern of headwinds and tailwinds that CEOs are likely to face during their years in the role and upends some common views about CEO tenure and value creation. For example, it suggests that some boards part ways with a strong CEO too early after a predictable and often temporary performance slump, while others tolerate a mediocre performer for too long.

Understanding this pattern—and the critical moments when performance tends to shift—will enable a new dialogue between boards and CEOs. Recognizing the typical stages of value creation can empower boards to drive accountability, support CEOs at each stage in the best possible ways, and think about the sustained success of the organization. For CEOs this framework can help build trust and transparency with directors, manage expectations, adapt to the changing context of their tenure, and assess, as one CEO told us, "the incredibly difficult question of

'Are you still the right one for the task ahead?'"

Rarely do any two CEO tenures look alike. Each leader is on his or her own journey and faces very specific circumstances. Still, by comparing CEO performance on the basis of years in office rather than calendar years, and by viewing a composite of individual journeys, we have identified five distinct stages of value creation that many CEOs will experience during their tenure.

#### YEAR 1

### The Honeymoon

Most CEOs achieve above-average performance in their first year. They enter the job with fully charged batteries, ready to take the lead. "In most cases, the person has longed for the job and has given thought to how they would operate and energize the organization," one director told us. Enthusiasm for change lifts the stock price and unites investors, the board, and the organization.

During the honeymoon, CEOs learn to deal with competing priorities, decide where to focus their attention, and determine which stakeholders deserve a portion of their limited time. The key differentiator for later success is how much the new CEO learns versus merely operates. With so many demands on his or her time and attention, it can be easy to get stuck in execution mode. Actively developing the ability to step back, reflect, and recalibrate in view of early experiences expands a CEO's tool kit, improves pattern recognition, and increases speed to action.

Most new CEOs find themselves on one end of the organizational-health spectrum as they enter the role. Either they inherited an enterprise with sound operations and a defined strategic direction or they're now in charge of one in crisis, requiring a turnaround. For CEOs in healthy companies, less is

more; the initial goal is to continue along an established path. Those inheriting a crisis take bold action instead. Though their approaches differ, both groups tend to experience a honeymoon, with optimism fueling above-average share performance.

Looking back at this period, some CEOs recognize that great financial results in their first year may have set an unrealistically high bar, potentially sowing the seeds for problems during the next stage. One chief executive recalled, "The stock overshot. You get momentum investors. But the CEO can't go out and say, 'You know what? The stock's too high.' The reality of performance hit, and we underperformed [in our second year]."

#### YEAR 2

### The Sophomore Slump

After the exuberance of the honeymoon, the pendulum typically swings the other way, often driven more by unmet expectations than by significant problems. In some cases, an unanticipated challenge will garner more negative attention from investors than it deserves. As one CEO put it, "Somewhere in the first 12 to 18 months you are going to run into a buzz saw."

CEOs should recognize the frequency of sophomore slumps and manage expectations about a potential slowdown. "Even when you think you're communicating too much, you're probably not communicating enough," one director said. CEOs and boards can turn this early period of underperformance into an opportunity to work closely together, further refine strategic direction, and—most important—build trust and reset where necessary. When they recognize that they're in this stage, directors are more likely to remain calm, support the agreed-upon direction, and not encourage management to take action for action's sake.

However, a large performance dip during which the CEO and the board



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cannot sufficiently align may set the stage for future trouble. Our data shows that CEOs who experience a deep sophomore slump are significantly more likely to be ousted in later years.

High-performing CEOs told us that full transparency with the board, the leadership team, and investors helped them navigate the second year. They gathered valuable feedback and proactively sought one-on-one conversations to increase buy-in. Because of these trust-building actions, much of the early goodwill persisted, even as performance lagged. Boards should ask critical questions during this period, but they should do so constructively and supportively. A dialogue will help bring expectations—both positive and negative—closer in line with reality.

## YEARS 3 TO 5

### The Recovery

If they survive the sophomore slump, most CEOs enter a period of favorable tailwinds. Their moves in the first two years begin paying off. The board has had a front-row seat for the CEO's handling of the slump; investors can see positive outcomes and signal support. "You gained the trust of your team and coalesced by facing a crisis together," one CEO told us.

CEOs in this stage are working hard for the future. By now their imprint is all over the organization: The strategic direction is set, the organizational culture continues to evolve, and positive board dynamics have been established. For some CEOs this is an ideal time to pursue M&A opportunities. It's also

when they experiment with ideas and plant the seeds for new initiatives, whether in R&D, product cycles, or capabilities to advance the strategy—often under the radar of other stakeholders. This is a period, said one CEO, when "your actions and the amount of work are not reflected instantaneously in performance and may be punished by the market in the short term." By now the CEO should have enough experience to deal with that disconnect.

CEOs who have not thoroughly recovered from the sophomore slump can find themselves under growing pressure from the board. As one director told us, "It's in the third or fourth year when the board starts asking the really hard questions." Some CEOs who had come under pressure during this period told us they wished they had spent more time with directors outside the boardroom early on to build strong relationships. Many successful CEOs had done so, often going out of their way to meet with individual directors while traveling.

Toward the end of this stage, CEOs risk developing a blind spot. Confidence can turn into overconfidence, particularly if they've had several years of high performance. Some become restless. They may miss the frequent promotions and job changes they experienced on their path to the role—or recognize the strain on their lives and their families. Others start to focus on legacy-related questions; they think and talk about purpose. Some think about how long big investments will take to pay off and hesitate to put a lot of time and effort into a bet that might not be profitable until after they're gone.

## YEARS 6 TO 10

### The Complacency Trap

The recovery period is often followed by a time of prolonged stagnation and mediocre results. Performance may not be outright negative (and in some cases may be camouflaged by a rising market), but CEOs tend to struggle to deliver at the level of earlier years. One strong year may be followed by a couple of weaker ones. Unsure of whether a poor year signals major problems on the horizon, some boards delay intervening, whereas others act quickly to remove a CEO. Many CEOs in our data set left during this period, as you'd expect given the average tenure.

As CEOs enter this stage, the risk of complacency is high—at the CEO, board, and organizational levels. Now that they're sitting firm in the saddle, some relax their grip. Some become overinvolved in outside activities—boards, speeches, charities—and are distracted from work. After several years in the top position, maintaining personal energy and keeping up with a fast-changing world are taking a toll. Several directors pointed to an incrementalism trap in which CEOs start to think about success less daringly or resist taking a hard look at their past decisions. In the early days, they were making changes to their predecessors' decisions; now they need to revisit their own and admit when they've run their course. That can be more difficult.

CEOs who outperform in this stage recognize the need for reinvention. They stay focused on the business and continue to question the status quo. "Complacency was my biggest

concern,” one told us. “Inside the company, people started to assume that we were going to deliver great results....I had to say, ‘No, we’ve got to keep finding new ways of doing things.’” In contrast, some leaders adopt an “If it ain’t broke, don’t fix it” mentality and fail to sufficiently rethink strategy. Even when the CEO recognizes the need to pivot, inertia on the board can slow or prevent change. Uncertainty about what and how to change can drag out the process, perhaps until it’s too late. One director observed that many CEOs “get defensive when performance starts to dip, which doesn’t serve them well.” Instead they should look for new opportunities for the company.

Some CEOs and directors describe this as a period of delayed gratification, when they willingly forgo short-term gains for long-term bets. These transformation efforts have the potential to reshape the organization, often with far-reaching effects on the business model. But pressure for short-term gains may continue to build, requiring CEOs and directors to stay closely aligned on the vision and the time frame. Delays in M&A activity or the product development cycle, longer-than-anticipated integration periods, or missed synergy targets add further pressure, temporarily dragging down TSR and distracting from potentially big payouts from a successful transformation. One CEO told us, “It is a painful period when product A is starting to decline but you can’t talk about product B that will succeed it. You know there’s a great story to tell; you just can’t tell it yet.”

For boards, the onset of the complacency trap presents a crucial question: Is our CEO a sprinter or a marathoner? Directors grapple with whether to bring in someone new or commit to a long-term vision with the incumbent. Our data shows that performance often spikes in the year of a significant event—a major acquisition, a technological innovation, a transition in a product

cycle, a geographic expansion—with depressed returns in the preceding or following years. The board may begin to wonder whether the CEO is simply running out of ideas. One director said, “Some people have a clear view of how to steer the ship in the early years. I won’t call them one-trick ponies, but they do then struggle in their second act.” Even if directors begin mulling a leadership change, they tend to be hesitant. “The downside of a change in CEO seems huge to a board,” said one director. Our data suggests that boards should act decisively: Either accelerate the succession or protect the CEO from outside pressure.

#### YEARS 11 TO 15

### The Golden Years

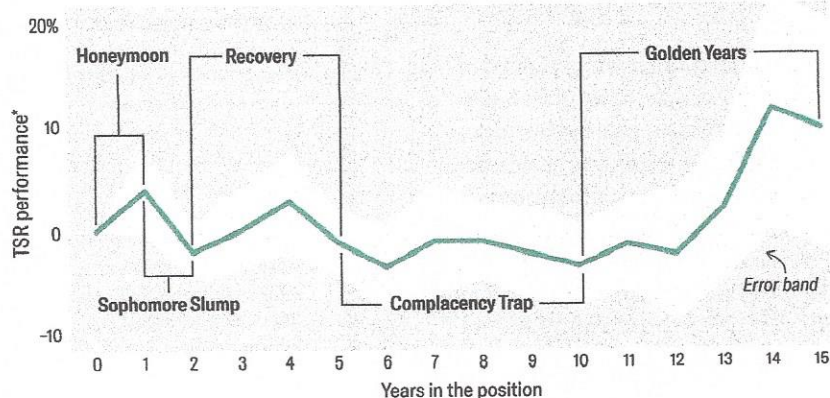
CEOs who survive the complacency trap typically go on to experience some of their best value-creating years. Their

long-term commitment and ability to reinvent themselves and the company are coming to fruition. Some CEOs described a flywheel effect: Projects and investments that produced no results early on were finally paying off.

By now boards’ additional trust in their CEOs has proved to be warranted. The CEOs have gained deep institutional knowledge, led through business cycles, and mastered several crises. The likelihood that one good year will be followed by another steadily increases. These CEOs have learned to navigate complex multi-stakeholder situations. “When you survive into the golden years, it means that...you have not only managed the company well, but managed your board well, managed stakeholders, anyone who could call into question your continuing survival at the top,” said one CEO. Many of the long-tenured CEOs we interviewed were motivated by the idea of building a legacy.

## THE FIVE STAGES OF CEO VALUE CREATION

A team of researchers at Spencer Stuart tracked year-by-year financial performance over the complete tenures of 747 S&P 500 CEOs and conducted in-depth interviews with some of them to illuminate the pattern of stages below.



\*TSR is market adjusted: Company shares may have shown a positive return for a given year but appear here as a negative number because they lagged the wider market.

## Spotlight

Their performance is explained in part by our sample. Most CEOs have dropped out of the race by this stage, whether for performance, health, or personal reasons, so it's the strongest leaders who stay longer than a decade. Indeed, when we have shared our data, some observers have questioned whether the outperformance of the golden years is due solely to this survival bias—the fact that weaker leaders were weeded out earlier. But our research shows other factors at play. When we investigated attrition rates in our data, we saw CEOs leaving the job in consistent numbers year in and year out. If attrition alone explained the ups and downs, we would see corresponding movements in attrition and performance. Additionally, those CEOs who lasted into a second decade show a similar pattern of highs and lows over their tenure. Their survival wasn't simply a function of their performance; the credibility and trust they built with the board and investors helped them stay the course in challenging years.

In this stage the timing of succession becomes a key question for boards and CEOs. High-performing CEOs often have more discretion about when to step down. "If you're successful for 10 years or so, it's very hard for board members to look you in the eye and say, 'You ought to go,'" said one CEO. "So you could stick around a long time and yet not be doing your job as well as somebody else could. I wanted to leave on a high note." Although companies and investors benefit from having a high-performing, long-term CEO, it can complicate succession planning. A recent PwC study confirmed our findings that long-serving

## OUR METHODOLOGY

We analyzed the entire tenures of 747 S&P 500 CEOs who left office from 2004 to 2017. Their time in the role ranged from three months to 41 years. We first calculated each company's annual market-adjusted total shareholder return (the difference between the company's TSR and the S&P 500 TSR) for each year in a CEO's tenure. That produced 7,000 discrete performance observations, which we used to create an average baseline representing how CEOs fare each year, regardless of market environment. Next we standardized the data for easier comparison.

Instead of typical time-based comparisons, which would look at how

various CEOs performed in a specific calendar year, we examined CEO performance on the basis of years in office. For example, instead of comparing how all CEOs performed in 2012, we looked at how each one performed in the first year on the job, in the second year, and in the following three stages. This way we not only randomized market effects and industry trends but also could compare CEOs who were operating in different slices of time.

To rule out alternative explanations for the performance differences we observed, we examined organizational and individual data that might have had a material effect, such as the decade in

which the CEO started, the industry, prior CEO or board experience, age at start date, gender, founder status or IPOs, revenue and income changes, capital expenditures, market cap, and extraordinary events like the global financial crisis. We included these inputs in multilevel statistical models to discover how variables affected performance and to confirm that our results still held.

After analyzing the data, we conducted 41 interviews with high-performing CEOs in our data set and board directors who observed those CEOs to understand how leaders and boards think and talk about performance, tenure, and the critical moments and milestones in a CEO's career.

CEOs outperform others, yet succeeding a legendary CEO disproportionately results in underperformance and potential removal from office.

**CORPORATE BOARDS ARE** under more pressure than ever before. Activist shareholders have become adept at exerting outside influence and keeping directors on their toes. Index funds, which can't sell shares when they are unhappy with a company's leadership or governance, increasingly use their influence to hold boards accountable for CEO performance. This external pressure raises the odds of adversarial dynamics between CEOs and directors, leaving many CEOs feeling unsupported and misunderstood. Boards' own view of their role has also expanded: Many now seek to add value to the most important

decisions facing the company, ranging from strategy to talent and culture.

Our framework gives executives and directors a common language for candid conversations about potential risks and opportunities at each stage. It can help boards view performance in a larger context and avoid overreacting in moments of doubt—or tolerating mediocrity for too long. It can also help them collaborate on succession planning and identify an optimal moment for the leader to step down. © **HBR Reprint R1906B**



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