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Companies Face Risk by Failing to Vet Internal C-Suite Candidates

Boards should approach internal candidates the same as they would external candidates

By Nick Muscavage | September 25, 2023

Companies often make the mistake of vetting internal C-suite candidates to a lesser standard than external ones, but failing to properly screen internal candidates could harm shareholder value or the company's reputation, experts warn.

Moreover, if a candidate is appointed to a C-suite role and later departs unexpectedly, it can "cast a shadow on the preparedness of the board or the professionalism of the board," said **Brendan Foo**, co-CEO and co-founder of Forward Risk, the investigations and intelligence practice of **Forward Global**.

Scrutiny can hit boards whether they carried out a fulsome vetting process or not.

For example, the Sept. 12 departure of **BP CEO Bernard Looney** after a three-decade career at the oil giant has shareholders and other observers questioning what the board knew about Looney's past relationships when it named him chief in 2020. The resignation follows a fresh board investigation into Looney's alleged past personal relationships with colleagues. The company said Looney "was not fully transparent in his previous disclosures," according to its 6-K filing.

According to the **Financial Times**, the board did discuss some of Looney's past relationships during his vetting process and determined there was no abuse of power. However, it learned of additional relationships this month.

“Why was there not a clearer message that you don’t jeopardize the wellbeing of the company for this kind of thing?” a major shareholder asked, according to the FT.

Other executives have also recently departed roles after lengthy tenures with their company.

In November 2022, **Ozan Dokmecioglu** resigned as **Keurig Dr Pepper**’s CEO for unspecified violations of the company’s code of conduct. He had become CEO just three months earlier. Dokmecioglu was previously the company’s chief financial officer before becoming CEO and was the chief financial officer of **Keurig Green Mountain** before its merger with Dr Pepper.

Additionally, in April 2022, **Ralph Lauren**’s chief commercial officer, **Howard Smith**, resigned from the company after a board investigation found he had violated the company’s code of business conduct and ethics, according to an 8-K. The board launched the investigation after receiving allegations of Smith’s personal conduct, but it did not specify what those allegations were. Smith was with the fashion retailer for 19 years, joining Ralph Lauren as a vice president in its logistics department before eventually rising to the C-suite.

“People Change”

Sources in the investigations business said companies sometimes vet internal candidates for C-suite roles less vigorously than external candidates, especially since most internal candidates would have faced a rudimentary pre-employment background check when they were hired — but that could have been many years, or even decades, ago.

There’s a perceived notion of, “Oh, that person has been with us for these many years. We don’t need to spend money on a background check or even do any of our own

vetting, because the person was already hired,” said **Chris Procopis**, co-founder of **LexPro Research**, a background research and corporate investigations firm.

Similarly, companies can develop a level of comfort around internal candidates and become “short sighted” when it comes to vetting them for C-suite roles, said **Sabina Menschel**, president and COO of vetting and investigations firm **Nardello & Co.**

“They could have come to the firm 10 years ago, and maybe the company even did a background check 10 years ago, but things could have happened in that time period,” she said, adding that lack of vetting can lead to “potential exposures” for a company.

Boards of directors should always apply the highest possible standards when selecting executives, regardless of whether the new leader is recruited externally or internally, according to **Daniel Schauber**, founder of CEO-exit research firm **Exexchange**.

Nevertheless, he said, boards may be tempted to screen internal candidates less thoroughly than external candidates if they believe they already know the internal candidate’s character and skills well enough.

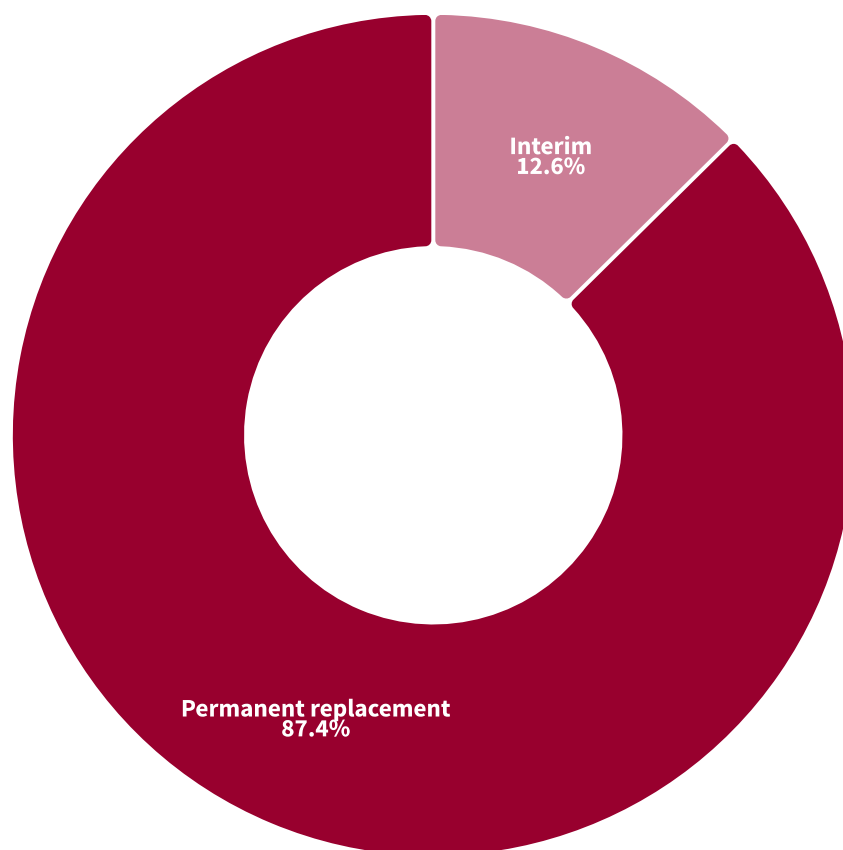
“But people change when they get into leadership positions,” Schauber said. “If a new leader turns out to be a misfit, regardless of whether they were recruited internally or externally, the board is forced to take immediate action. All of this brings unrest into the company.”

Meanwhile, after a sudden CEO departure, it is also relatively common for the board to be unable to present a permanent successor, suggesting — at least to outsiders — an additional lack of preparedness, according to data analyzed by Exexchange.

The research firm studied 1,940 CEO departures in the Russell 3000 from Jan. 1, 2017, to Sept. 6, 2023, and found that there were 244 cases, or 12.6% of the total studied, in

Most CEOs Replaced by Permanent Successors

Russell 3000 CEO successions from Jan. 1, 2017, through Sept. 6, 2023



Source: Exchange • Note: Analysis consisted of 1,940 total successions.

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✶ A Flourish chart

which the company was unable to name a permanent successor when the CEO left unexpectedly.

“When CEOs leave abruptly and there is no permanent successor available, it creates uncertainty for the company and investors and also casts a dubious light on the board, which appears to have failed to groom a successor who can take over immediately in the event of a surprise departure of the incumbent CEO,” Schaubert said.

In cases where the departing executive rose internally, that scrutiny is intensified.

“Of course, no matter how carefully a board selects a CEO, it cannot look into an executive’s head,” Schaubert said. “But when internally recruited CEOs have to vacate their posts for conduct issues shortly after taking office, investors may question whether the selection process was careful enough and what the board may have overlooked.”

The Board’s Role

When searching for a CEO, the board serves as the search committee and works closely with recruiters, but for other C-suite roles, the search is typically led by management, and the board plays a supporting role. Normally, internal and external candidates should be handled the same way, according to **Pam Lenehan**, a board member at telecommunications company **ATN International**.

“However, many times internal candidates have been specifically hired and developed to take over a senior role as part of a succession plan, and the board has been assessing their performance since they have been hired,” Lenehan said. “In this situation, internal candidates still need to articulate their vision for the new role but may not be assessed by an outside firm.”

Hiring a CEO is the most important decision a board will make, and the wrong choice can significantly impact the value of the company and the ability to attract high-caliber people, she said. At the same time, companies can face another form of risk by passing over internal candidates for CEO or other C-suite roles. When that occurs, the internal candidate may decide to leave the company.

“That is why directors spend so much time on CEO succession,” Lenehan said. “I have been involved in eight CEO successions — three planned and five unplanned — and, as expected, the ones that were planned had the most successful outcomes. In each planned succession, the new CEO came from the C-suite, was a known quantity and

had been mentored by his predecessor and the board before taking over.”

With CEO departures stemming from personal relationships — as was the case with Looney’s leaving BP — boards are increasingly asking candidates for CEO roles if they have ever been in relationships with employees at the companies they are interviewing for, according to a **report** from the Financial Times.

Meanwhile, when it comes to personal relationships, directors are beginning to create a set of standards of what’s acceptable for the average employee and what’s acceptable for executives.

Vetting Methods

When looking into C-suite candidates, vetting experts said, there are generally two forms of background checks: open-source checks, which involve searching public records, and reputational interviews, which involve speaking to acquaintances of a candidate.

“For an internal candidate, there’s no reason not to do the comprehensive open-source [check],” Menschel said. “There could be a whole host of things that are sort of going on unrelated to their actual job that you would maybe want to know about.”

Additionally, reputational interviews are key to gaining a better understanding of how someone behaves beyond what’s portrayed in the public record, according to **Michael Levien**, co-founder of LexPro Research.

“If you look back far enough and close enough and in enough places, you might find some previous record or evidence of that person’s behavior,” he said. “What’s in the public record might not accurately reflect the person’s behavior.”

A candidate's public records could show no criminal records, liens or judgments or that they've never been sued or declared bankruptcy, but another picture could emerge if a vetting firm were to interview former colleagues, neighbors and classmates, according to Levien.

For instance, reputational interviews could reveal that a candidate constantly makes inappropriate comments or jokes or was accused of doing something inappropriate in college and was never caught or charged, he said.

Some companies go a step further and conduct background checks on employees on a routine annual basis, according to **Jeanne Carrillo**, director of operations at LexPro Research.

“They’re looking at key executives in very specific key positions of the company, everything from payroll all the way up the line throughout the C-suite,” she said. “Having that follow-up background check is a really good audit trail, and that’s an additive and I think that’s part of the best practices we would recommend.”

Contact the reporter: nmuscavage@agendaweek.com

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