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*The most successful CEOs, on balance, are those who are developed inside the company—but manage to retain an outside perspective.*

## Solve the Succession Crisis by Growing Inside-Outside Leaders

by Joseph L. Bower

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# Solve the Succession Crisis by Growing Inside-Outside Leaders

## The Idea in Brief

Should companies needing a new CEO pick someone from inside or outside? Insiders know the firm and its people, but they're often blind to the need for radical change. Outsiders see the need for change, but don't know the company well enough to foster it.

Fortunately, says Bower, firms don't have to compromise. Companies delivering superior, sustained performance—P&G, IBM, GE—have **inside-outsiders** at the helm. These CEOs have ascended within the organization while remaining detached enough from its cultural norms to maintain an outsider's objectivity. They know the firm but also understand how it will have to change. They're able to look at the organization as if they just bought the company.

Growing inside-outsiders takes patience. Over a decade or more, your firm must groom high-potential executives through increasingly challenging assignments and rigorous mentoring. But the effort pays big dividends: Your company has access to an able CEO—whenever it needs one.

## The Idea in Practice

### HOW COMPANIES GROW INSIDE-OUTSIDER LEADERS

- **Recruit right.** Hire from a diverse pool of individuals who are highly talented in their area of specialization and who have general-manager potential. Over time, they'll become good insiders—learning to manage in the context of the company's strategy, systems, and culture.
- **Identify insiders blessed with an outside view.** Often, they come from outside the organization's mainstream; for example, spending extensive time away from headquarters.
  - ▶ **Example:** Before becoming CEO, Procter & Gamble's A. G. Lafley spent years in Asia building P&G's Chinese operation—and working in beauty products rather than its core detergent business. His resulting broad view of P&G's potential likely laid the foundation for the series of acquisitions that have substantially expanded P&G's business' reach.
- **Groom potential inside-outsiders.** Hand them increasingly complex assignments that ready them to manage a whole business as early as possible. If you're a one-business company, identify distinct units—such as geographical regions with markedly different competitive conditions—that promising inside-outsiders can run.
- **Mentor.** Assign senior managers to oversee inside-outsiders' development. These mentors help protégés extract lessons from each assignment, such as learning how to ratchet up growth while still delivering current performance. Mentors also ensure that there are adequate (but not excessive) resources for protégés to turn new ideas into great businesses.

### HOW YOU CAN BECOME AN INSIDE-OUTSIDER

- **Pick the right employer.** Look for companies that will provide a clear career path, mentoring, challenging assignments with enough time to learn from them, early general management responsibility, and chances to try out new ideas.
- **Prove yourself on the job.** Meet your numbers, help your peers, and develop your direct reports. When bringing problems to your boss, also suggest solutions. Cultivate a group of senior-manager friends who back your ideas with resources.
- **Broaden your view.** Network with people outside your division and company, including customers, vendors, related organizations, and union leaders. Expand your general knowledge beyond your immediate business through seminars and out-of-mainstream experiences.
- **Solicit unvarnished truths.** The higher you rise in your organization, the more people will tell you only what they think you want to hear. So cultivate a relationship with someone—spouse, close friend, mentor—who tells you the truths you *don't* want to hear.

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by Joseph L. Bower

I was appalled to learn recently that 60% of the respondents to a poll of 1,380 HR directors of large U.S. companies said their firms have no CEO succession plans in place. As this finding suggests, too many companies have over the past two decades ignored the hard work of building future leaders while senior executives have focused increasingly on meeting the next quarter's earnings target. When the time comes to name a new CEO, more firms look outside. Yet strong evidence supports the notion that a well-groomed insider is a key to sustained company performance. In my analysis of 1,800 successions, for instance, I found that company performance was significantly better when insiders succeeded to the job of CEO. Other researchers, including Jim Collins in *Good to Great*, have come to similar conclusions working from different data sets.

Such quantitative research on CEO succession confirms but does not explain why more outsiders are being hired, why qualified insider leadership correlates with better company performance, or what relationship exists

between those two trends. These ambiguities have prompted me to consider what I could add to the data-centered research from a qualitative review of a decade of my own and others' case studies and interviews, as well as from my experience managing successions as an outside director. That review made one thing unambiguously clear to me: A critical difference between companies that manage succession well and those that don't is the understanding that succession is a process, not an event. The process begins years before the event. Something else was clear: Both insider and outsider CEOs have strengths and weaknesses when they begin. Insiders know the company and its people but are often blind to the need for radical change—they've drunk the Kool-Aid. Outsiders see the need for a new approach but can't foster change because they don't know the company or industry sector well enough. What organizations need, then, is to find a way to nurture what I call *inside-outsiders*—that is, internal candidates who have outside perspective.

For some companies, that may look like mission impossible. But the succession crisis will only get worse if companies don't tackle the problem.

### The CEO Does Matter

Recently, there's been a reaction against focusing too much on the CEO—with some justification. Top teams, as much as CEOs themselves, are crucial to the execution of a great strategy. Nonetheless, strong CEOs are worth studying. They wield enormous power. And as stewards of the corporate purpose, their ability to make sense of the business environment and to craft and articulate the mission and the strategy are central to long-term success.

Nothing illustrates the point better than the last 35 years of succession at General Electric. Reginald Jones took the helm at GE in 1972. He developed the strategic-planning system he inherited from his predecessors into the model for companies everywhere. He made huge changes in GE's portfolio, exiting the computer business and acquiring the giant inflation hedge, Utah International. Jones's GE regularly outperformed the U.S. GDP by more than 25%. Recognizing the dawn of a very different environment in 1981, successor Jack Welch proceeded in two or three years to dismantle much of the planning and organizational structure Jones had put in place. Welch sold Utah, acquired RCA, and built a huge financial services business. Entire levels of middle management and staff disappeared. In the second decade of his tenure, GE's market capitalization grew more than 1,000%. Welch's successor, Jeff Immelt, is changing GE once again. He is making major investments in biosciences, water, security, and platforms for infrastructure growth in emerging countries. The stock market is giving him the same cool reception it gave Welch in his first decade, but GE is growing both revenues and profits as it changes.

What GE's CEOs exemplify is the ability to perform four seemingly contradictory tasks (a near-impossible quadracta):

- Produce good short-term performance regardless of how the markets and competitors buffet the company they've inherited.
- Deploy resources so that organizational capabilities improve in the medium term.
- Align the talents and energies of hun-

dreds of thousands of employees with clear strategic objectives.

- Develop and modify those objectives over the long term so that strategy adjusts to the changing business environment.

This is a feat that simply cannot be done by a team. It can be pulled off only by an individual with a clear vision.

The job is inherently difficult—and becoming more so. CEO turnover is on the rise globally, and studies show that the proportion that can be traced to inadequate performance is steadily trending upward. Why should the job be harder now than in the past? I see two reasons. First, arguably, market conditions are making the task of getting good results harder. Hypercompetition, changing technology, and a raft of emerging players from every corner of the globe are pressuring companies to keep changing their game, and a lot of firms are just not doing it very well. When I took a look at the performance of U.S. firms over the last five years and discounted the top two firms from any industry, the rest, on average, failed to earn their cost of capital. Second, owner expectations have changed radically. In a world where markets are growing 5% annually, the stock market is looking for 15% returns. Institutions count for an increasing share of ownership, and their holding period is getting shorter—under a year is now typical. These are not owners so much as speculators in for the short ride.

### Outsiders, Insiders, and Hybrids

When company performance disappoints, boards of directors tend to seek a white knight from the outside to come in and change everything. Most of the time, the only way to change things fast is to cut costs—which is exactly what someone unfamiliar with the specifics of an industry and its markets, or the company and its people, is likely to do first. Yet a study by Booz Allen reports that outsider CEOs who make a quick mark by cutting costs generally fail to succeed in the long run: After two or three early years of squeezing more to the bottom line, the CEO leaves or sells the company. This short-term orientation destroys value in the medium and long terms. The seeds of growth are eliminated along with overhead.

When a board looks inside for future leaders, all too often it sees men and women who

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*Being outside the mainstream allows for a certain detachment from the conventional wisdom and prevents managers from being cowed by a powerful CEO.*

don't seem to have the stature and vision to lead. In the board's view, they are good operators, but they lack a strategic sense: They have never run a business in anything like the circumstances that loom on the horizon. And where no systematic effort has been made to build future leaders, that perception may be correct.

But there's no better way to reverse the long-term destruction of shareholder value than for companies to commit themselves to growing executives from inside the company who are prepared to lead through good times and bad. Simple? No. The right thing to do? Absolutely.

Consider the four skills that a new CEO needs to drive a company forward and produce the results cited above:

- Judge where the world and the company's markets are headed, and frame a vision of how the company should reposition itself.
- Identify (and if needed recruit) the talent that can turn this vision into reality.
- Understand, in a deep and substantive way, the problems the company faces.
- Know, comprehensively, how the company really works—in other words, be plugged into its administrative inheritance and know key players well.

True, carrying out these tasks requires a clear outside perspective. Industries are regularly transformed by changes that disrupt traditional economic relationships. That's what the Internet did to the world of personal computers and minimills did to the big, integrated steel producers. It's what high-quality, low-cost Asian manufacturers did to a whole set of businesses based in Europe and the United States. Individuals with an outside perspective can see such trends as they're happening.

But three of these four leadership skills require extensive inside knowledge. Executives who successfully lead large corporations to new heights usually have accumulated a body of knowledge over a long span of time, much of which is specific to the company they're leading and the industry it's a part of. They can assess the talents of their colleagues relative to the skills needed to compete in a new situation. When, in response to a change initiative, colleagues declaim, "We can do that," insiders can distinguish wishful thinking from an accurate recognition of vital, new

internal capabilities—and they can do so early on. It's hard to overstate how important it is to understand, when competing in a new field, the true value of recognizing a winning versus a wannabe capability.

My research suggests that as a rule the best leaders are, therefore, people from inside the company who have somehow maintained enough detachment from the local traditions, ideology, and shibboleths to maintain the objectivity of an outsider. They know the traditions and the people of the company but also know how those will have to change. They know what best-in-class looks like as well as how the class will change. They're able to look at the organization's administrative heritage as if they had just bought the company.

How do they preserve that view? Often they come from outside the mainstream of the organization. They've spent more of their time away from headquarters living with new opportunities and threats. If you've been living in modern Shanghai, for instance, you're aware that the threat from China is not cheap labor.

Am I advocating the elevation of eccentrics and misfits? Of course not. Procter & Gamble's A.G. Lafley spent the years before becoming CEO in Asia building the Chinese operation—in beauty products rather than the core and very mature P&G detergent business. His resulting broad view of P&G's potential may have laid the basis for the series of major acquisitions that have substantially widened the domain of the company's businesses. IBM's Sam Palmisano was a champion of software and open systems at a time when Big Blue was essentially a closed-system, hardware-oriented company. Again, his broader view of how IBM should compete appears to have shaped the company's progress as a systems and services solution provider. What Jack Welch built into a world leader was GE Plastics—not engines, lighting, or appliances (which were GE's core at the time). Welch once told me, "One of the things that I was lucky about in my early days in GE: I got good businesses and I saw bad businesses. I was managing diamonds—industrial diamonds—and semiconductors. So one of the advantages of being in a business with a 50% margin and moving to a business with a 4% margin is that you can tell the

difference between the two, and you want to get rid of [the 4%] and keep [the 50%.]"

Being outside the mainstream does two things for a high-potential manager: It allows a certain detachment from the conventional wisdom to develop, and it keeps the manager from being cowed by a powerful CEO. As one CEO said to me, "Acorns don't grow well in the shadow of great oaks."

### Growing Leaders

How do you build a pipeline of future leaders that includes inside-outsiders? It begins with recruiting from a diverse pool of individuals who are both highly talented in their area of specialization and have the potential to be general managers. Over time, they will learn to manage effectively in the context of the company's strategy, systems, and culture—they will become good insiders. The best of them will also see the potential for radical improvement, and that vision may ultimately match up with the sense the board and the departing leaders have of where the world is headed. Grooming that kind of insider—the

one blessed with an outside view—should be the fundamental goal of the executive development process. If building the skills these managers need takes a decade or more—and if they are to assume leadership positions while they still have at least a decade of service ahead of them—they need to be on board and identified for grooming by the time they are 30.

"Grooming" may be a bad word for the development process, as it sounds more cosmetic than it really is. What high-potentials need is to be handed a series of increasingly complex assignments that give them the chance to manage a whole business as early as possible. That means the company has to be organized into more than one business unit—even if it is basically a one-business company. Sometimes regions are distinct enough to benefit from different managers. Western and Eastern Europe are like that today: One market is mature, highly developed, and very competitive; the other is growing rapidly under rapidly changing conditions. Thus managing them is quite genuinely two different jobs.

## Becoming an Inside-Outside Leader

If you want to become a company leader—and especially if you want to be an inside-outside CEO—you need to manage your own development from the start. These questions can help you keep the big picture in mind.

### At recruitment

- **Why are you being hired?** Is it just for a job today, or is there a career path?
- **Is this a company where talented people stay for many years?** If not, will the experience it provides make you attractive to future employers?
- **How will the company help you grow?** What pattern of assignments will you get? Will you have time to learn?
- **What kind of mentoring will you receive?**
- **What kind of training is offered?** What is done in-house? What is done through outside programs?
- **How soon can you run a business?** If you don't get general management responsibility early, you can't learn the job.

- **Is this a cookie-cutter program, or are young people given the chance to try out new ideas?**

### Now that you're on the job

- **Do you meet your numbers?**
- **Do you help others?** Are *you* developing their talent?
- **What do you do for your peers?** Are you just their in-house competitor?
- **When you manage up, do you bring problems—or problems with possible solutions?**
- **Are you transparent?** Managers who get a reputation for spinning events gradually lose the trust of peers and superiors.
- **Are you developing a group of senior-manager friends who know you and are willing to back your original ideas with resources?**

### Developing yourself

- **Is your network expanding outside your division?** What about outside the company? Have you visited with customers, vendors, and related organizations?

If you have a union, have you ever talked with its leaders?

- **Do you know individuals in your community who aren't businesspeople?** You can learn more about what you don't know from them than from people just like you.
- **Do you attend seminars or expand your general knowledge beyond your immediate business?**
- **Are you involved with the community in some way?** You can develop many leadership skills by working with an outside organization.

### Living a balanced life

- **Are you there for your family?** Managing can be lonely—support of family can be invaluable.
- **Have you cultivated a relationship with someone—spouse, close friend, mentor—who tells you the truths you don't want to hear?** The higher you rise in your organization, the more your colleagues will tell you what they think you want to hear.

*If leaders need a decade to develop and need to take the helm with a decade of service still ahead of them, they need to be identified by the time they are 30.*

As high-potentials move through this series of increasingly complex assignments, performance evaluation is critical. They must be held accountable and learn how to deliver, but they must not be abused by arbitrarily imposed goals. When young managers stumble, they should be mentored by talented senior managers. This mentoring is part of the senior manager's path to further growth as well.

Senior managers who are overseeing the development of talented junior managers should pay special attention to planning, budgeting, performance evaluation, and compensation—and to how these different processes are linked. When managed well, planning and budgeting present an endless series of development opportunities: learning how to present deliverable plans so that they are not arbitrarily raised to meet some corporate aspiration; learning how to ratchet up growth while still delivering current performance; learning how to present new ideas in such a way that they are not underfunded. These challenges involve, on the one hand, being held accountable for deliverables and, on the other, being given space to nurture new activities.

Earning and learning require different approaches to evaluation and compensation. Both entail accountability, but one set of targets and measures is pretty clear, while the other is often more ambiguous. Rewards need to reflect each in a way that is understandable. An individual might be promoted for success in building an operation over a number of years, for instance, but at the same time be denied a bonus based on a formula related to short-term earnings.

Oftentimes, the inside-outsiders appear to present a special challenge. They seem like mavericks to the extent that they do see outside the box. What this comes down to is that most people think some of their ideas are really weird. Indeed, these unusual ideas may not be sound until they're worked through. Inside-outsiders need encouragement, as well as protection from old-timers who might be inclined to teach them a lesson. That is the job of the mentor.

The critical moment is when the young high-potential shows up with something new

that just might be important. That is when the investment of a mentor's time is most important. It may take numerous meetings and a long walk or two to help the high-potential think through what it means to develop an idea in the context of the company. More often than not, the mentor will be at least as skeptical as the old-timer. The trick is to give the young manager the time and leeway to turn a new idea into a great business without giving him the rope to hang himself. The mentor must make sure resources are adequate but not excessive, dole them out stage by stage, and then wait and see. The mentor, in other words, is a kind of venture capitalist, teaching potential leaders how to make new ideas work.

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It takes world-class quality and cost control for any company to stay in the game. It takes fast-to-market innovation to sustain industry leadership. Those dual (and dueling) priorities have put great pressure on the men and women at the top. They must drive efficient operations and creative change at the same time, even though from a management perspective those tasks are nearly contradictory.

For both the company leadership and those who seek to become leaders, that means balancing the need to meet short-term expectations with the need to invest over the long term in the development of the organization's people. For management, development involves giving potential leaders jobs with increasing responsibility. Helping them maintain their unique perspective takes hours of mentoring; protecting them from the consequences of their mistakes requires careful intervention. Those who want to be chosen as leaders must build a track record of delivering in the short term while building for the long term. Both challenges are tough, but both must be met if we are to restore our companies to long-term competitive health.

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## Further Reading

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### ARTICLES

#### [Changing Leaders: The Board's Role in CEO Succession](#)

by Jay W. Lorsch and Rakesh Khurana

*Harvard Business Review*

May 1999

Product no. 99308

A company's board of directors can play an active role in cultivating inside-outsider candidates for the CEO role. How? Establish a management-development program focusing on the top three managerial tiers. Through this program, track candidates' assignments, identify their development needs, and define career paths preparing them for higher responsibility. Four years before the current CEO's expected departure, review and challenge his or her plans for the process throughout that period, with the goal of developing several strong candidates—not just the one the current chief favors. And get to know the candidates: Ask them to make presentations at board meetings and assess how they relate to peers.

#### [Ending the CEO Succession Crisis](#)

by Ram Charan

*Harvard Business Review*

February 2005

Product no. 8851

Long-term leadership development is essential to cultivating inside-outsider CEO candidates. To bolster your firm's development program, spot promising candidates early, then nurture them with the right on-the-job experiences. Move candidates through positions requiring responsibility for steadily larger, more complex P&L centers. If your company's not configured to provide such opportunities, create jobs—large projects, small internal organizations—that exercise a candidate's P&L muscle. One large company identified the head of its smallest division as the next CEO. Though brilliant and articulate, he had no experience running big businesses. The board created a deputy position in its largest division for him and

made the current division head his coach—granting the coach a bonus based on his protégé's success.

#### [How Leaders Create and Use Networks](#)

by Herminia Ibarra and Mark Hunter

*Harvard Business Review*

January 2007

Product no. 1727

Leaders who aspire to a CEO position need varied networks. Ibarra and Hunter detail three main types: **Operational networking** is geared toward cultivating stronger relationships with colleagues who will help you get tasks done. **Personal networking** engages kindred spirits from outside an organization in an individual's efforts to learn and find opportunities for personal advancement. Perhaps most important for the inside-outsider leader is **strategic networking** to develop relationships with people who can help uncover and capitalize on new opportunities for the company. When choosing an employer, look for companies that teach strategic networking skills as part of their leadership development programs.

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