KORN FERRY
Institute

Predicting financial gains

Rigorous assessment of key CEO leadership qualities can predict company financial performance—before a CEO is hired.

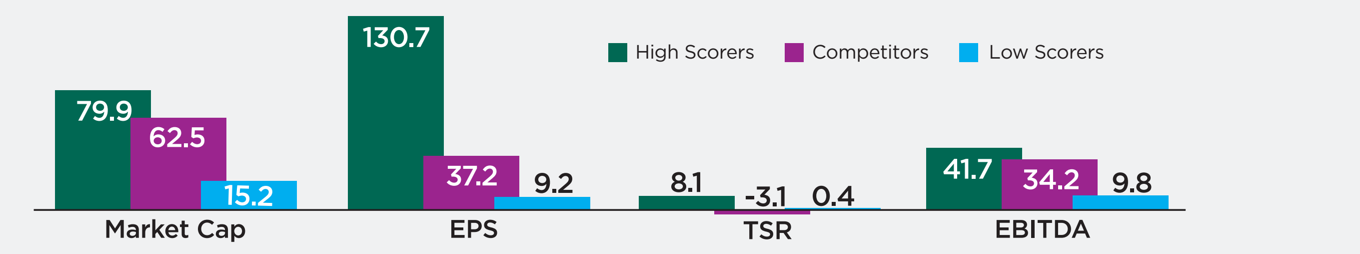
Choosing the next CEO is a high-stakes proposition, and arguably the most important decision a board can make. How does a board choose the best candidate? What if they could predict which CEO candidates would be able to increase the company's market cap over their tenures? What if they were able to distinguish between CEO candidates who would increase market cap by 80% versus 63%? Key indicators assessed in CEO candidates can predict market cap increases and other vital financial metrics.

The Korn Ferry Institute studied 229 leaders who participated in Korn Ferry's CEO Readiness Assessment and later became CEOs. The aim was to determine whether executives' scores on competencies measured by the assessment can be linked to their companies' financial performance. To obtain a baseline comparison for the CEOs' companies' performance, the study also tracked the financial performance of, on average, five peer companies per CEO company, over the same period of time, ranging from 1995 to 2016.

Over the CEOs' tenures, the companies whose leaders scored the highest across 17 measured competencies outperformed competing companies on percent change in market cap; earnings per share (EPS); earnings before interest, taxes, depreciation, and amortization (EBITDA), and total shareholder return (TSR).

Companies that rely on more advanced forms of CEO assessments to guide their succession decisions may see significant gains compared with their competitors. The difference can be as high as a 131% increase in earnings per share compared with competitors' average of 37%, and an 80% increase in market cap compared with competitors' average of 63%. Gains are also seen in TSR and EBITDA outcomes. CEOs who score the highest on Korn Ferry's Readiness Assessment outperform their competitors and lower-scoring CEOs.

Figure 1
The companies of the CEOs who scored the highest on Korn Ferry's Readiness Assessment saw greater percentage increase over their CEOs' tenures in market cap, EPS, EBITDA, and TSR, compared with groups of competitor companies. In addition to outperforming their competitors, CEOs who scored the highest on the Readiness Assessment saw greater increases in market cap, EPS, EBITDA, and TSR, compared to the CEOs who scored the lowest on the assessment.



Additionally, over the CEOs' tenures, the companies whose CEOs scored the highest across 17 competencies outperformed the companies whose CEOs scored lower on the assessment.[1] The study identified four competencies that most strongly predict financial outcomes: financial acumen, manages complexity, strategic vision, and aligns execution.

Figure 2

Buy or build these competencies to secure financial performance and CEO tenure.
Understanding the business.

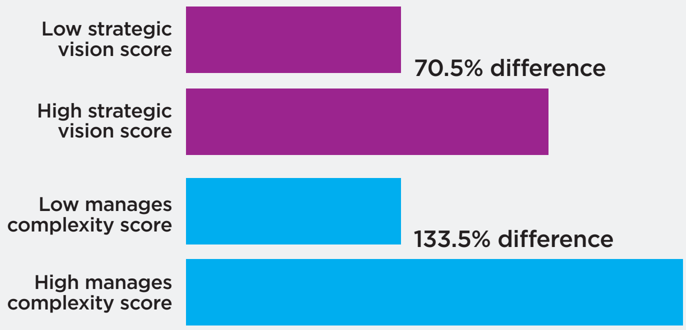
Understanding the business	
Financial acumen	Ensures the overall financial health of the enterprise by maintaining focus on financial metrics to improve financial performance and the firm's position in capital markets. Uses financial information to shape strategies, ensure sound investments, and build appropriate business models.
Making complex decisions	
Manages complexity	Addresses complex issues with incisive integration and analysis of information. Considers risks, implications, and contradictory information to solve intractable problems and make sound decisions in a timely fashion.
Creating the new and the different	
Strategic vision	Has a clear vision of emerging trends and of how value will be created in the future. Develops enterprise-wide strategies that are distinctive in the market to provide compelling value propositions for key stakeholders, drive growth, and build sustainable competitive advantage.
Managing execution	
Aligns execution	Plans and aligns organizational structure, systems, processes, metrics, capabilities, and resources with business objectives. Prioritizes, stages initiatives, and manages risk appropriately to ensure objectives are achieved.

Two competencies most strongly predicted increases in market cap and earnings per share, respectively: strategic vision and manages complexity. Selecting a candidate who scores one point higher than another (on the five-point scale used to evaluate each competency) on strategic vision would, on average, result in an additional 70.5% increase in market cap; the candidate who scores one point higher on manages complexity would, on average, result in an additional 133.5% increase in earnings per share (Figure 2).

1 The 229 CEOs' tenures were tracked, and four financial outcomes were recorded for the first year of their tenures and the last year of their tenures: market cap, EPS, EBITDA, and TSR. To standardize the impact of company age, industry, and size, the percent change over CEOs' tenures was calculated for increases in financial metrics. Multivariate analyses of variance were run to compare the overall difference (across market cap, revenue, stock price, EPS, EBITDA, and TSR) between high-scoring CEOs' companies and their competitor groups on financial outcomes; the difference was statistically significant (Pillai's trace = 0.11, $F(6,140) = 2.86$, $p = 0.011$).

Figure 3

A one-point competency difference can have dramatic effects on company performance: in strategic vision (teal) on average a 70.5% increase in market cap, and in manages complexity (orange) on average a 133.5% increase in earnings per share (EPS).



Korn Ferry's CEO Readiness Assessment takes candidates through a day in the life of a new CEO of a fictional global company with a diversified portfolio of businesses. As CEOs, they must develop growth strategies that may involve investments, acquisitions, or divestitures of current businesses. They undergo exercises where they interact with key internal and external stakeholders (who are Korn Ferry assessors). They must address issues ranging from sluggish top-line growth, investor concerns over missed expectations, executive team alignment, low employee engagement, and others. Also included are structured behavioral and career interviews and leadership, personality, and cognitive ability tests.

Conclusion

For many leadership roles, hiring decisions based on human judgment alone are less effective than a coin toss (Boatman and Erker, 2012). Past research on Korn Ferry's Readiness Assessments with mid-level leaders has found them to be 96% above average in predicting on-the-job performance (Goff, 2014). This research shows that these findings apply for CEO decisions as well. This indicates that boards can use research—verified, data-driven assessments like Korn Ferry's—in the high-stakes assessment and selection of CEOs.

References

Boatman, Jazmine, and Scott Erker. (2012). “Global selection forecast 2012.” Pittsburgh, PA: Development Decisions International Inc.

Goff, Maynard. (2014). “An eye for talent: Korn Ferry simulation assessments are 96% above average in predicting on-the-job performance.” *Proof Point*. Korn Ferry: Los Angeles.

Contributors

E. Susanne Blazek
Senior Manager of Thought Leadership
& Outcomes Research
Korn Ferry Institute

James L. Lewis
Senior Director of Research
Korn Ferry Institute

Jeff A. Jones
Director, Talent Analytics
and Data Systems
Korn Ferry Institute

J. Evelyn Orr
COO and VP, Research
& IP Development
Korn Ferry Institute

About Korn Ferry

Korn Ferry is the preeminent global people and organizational advisory firm. We help leaders, organizations, and societies succeed by releasing the full power and potential of people. Our more than 7,000 colleagues deliver services through our Executive Search, Hay Group, and Futurestep divisions. Visit **kornferry.com** for more information.

About The Korn Ferry Institute

The Korn Ferry Institute, our research and analytics arm, was established to share intelligence and expert points of view on talent and leadership. Through studies, books, and a quarterly magazine, *Briefings*, we aim to increase understanding of how strategic talent decisions contribute to competitive advantage, growth, and success. Visit **kornferryinstitute.com** for more information.

KORN FERRY
Institute