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Taking the "sudden" out of sudden CEO transition

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A scan of recent headlines is a reminder that CEO succession is not always a well-orchestrated victory lap for the departing CEO. A Board's decision to transition to a new CEO creates many different responsibilities to multiple stakeholders. Many Boards devote time regularly to succession planning throughout the executive team. Additional executive session time spent on planned and unplanned CEO succession is a good investment at the Board and Committee level to ensure that the Board provides leadership and a stabilizing force in a time of great uncertainty for customers, employees, and shareholders.

According to Spencer Stuart, 59 CEOs transitions occurred among S&P 500 companies during 2017, the most in the last 10 years. Of these, almost a quarter were because the former CEO resigned unexpectedly, either under pressure or for health reasons. Put another way, 3% of S&P 500 companies lost a CEO unexpectedly in 2017.

Sudden turnover also became more so in 2017 and 2018. A Temin & Co. study of CEO turnover highlights that the timeframe between announcement of a Board investigation and the CEO turnover is now two weeks, from more than six weeks just 18 months ago.

An effective succession plan acknowledges that the exact circumstances will be unknown and does not try to solve the problem in advance. Establishing a practice of open discussion among the Board and collaboration with the current CEO, HR, and General Counsel allow the flexibility to adapt the response as needed and more opportunity for thoughtful dialogue and communication around critical decisions.

Unexpected turnover forces the Board to make many important decisions in a very short period of time, so having had some discussion and developing key principles and high-level planning in advance supports peace of mind in the process.

What every Board should have in place

Beginning the discussion is hard. The need is not 'felt', or at least not to the same degree as other decisions that face the Board. Setting aside executive session time at a regularly scheduled meeting is critical to beginning the conversation, and likely the planning stages will span multiple conversations among directors, their advisors, and then the CEO and HR/Legal representatives of the company.

We stress that developing principles and first actions do not cast a plan into stone. The topic should be addressed on an annual basis as part of the Board/Committee agenda, and there's tremendous value just by having had some regular conversation and thinking on the topic.

From a practical perspective, these pre-emptive and regular discussions should cover 5 areas:

1. Identify a "point person" on the Board who is responsible for driving the activities surrounding the transition.
2. Identify the interim leadership structure (Chairman/CEO): almost always the interim CEO is a current executive or director. There should be open understanding of this role and the interim candidate should spend time with the Board and CEO to understand at a high level some of the nuanced elements of the business and build a relationship with the Board. If the outgoing CEO is also the Chairman, identify which director will take the role and whether or not it is a permanent or interim appointment.
3. Review employment agreements and plan documents that impact the CEO: knowledge of termination terms and potential financial exposure provide solid and vetted information without a lot of scrambling.
4. Review and affirm the company's code of conduct and confirm its applicability to other agreements. This also should include an understanding of how the company has treated code of conduct related terminations throughout the organization.
5. Draft a communication plan to cover employees and shareholders. This is more about understanding the timing requirements than the actual content of the messages.

What Boards should do when transition becomes a possibility

A lot will be asked of the Board and the interim CEO once a transition is closer to reality, often under tight timeframes requiring lots of coordination between the full board, Compensation Committee, Nominating and Governance Committee, and the interim CEO.

Search for New CEO: (Nominating and Governance Committee primarily responsible): The Board may choose to designate one or more directors to coordinate the search for a new CEO. Frequently this is a sub-committee of the Nominating and Governance Committee, and handles the CEO search process, engages with an executive search firm, interviews candidates, and coordinates with the compensation Committee on the incoming CEO's compensation. Additional committee retainer or meeting fees may be appropriate given the complexity of the search and the time commitment.

Pay for Interim CEO (Compensation Committee): The Compensation Committee must determine an appropriate pay package for the interim CEO that will appropriately align compensation during the interim period, typically lasting between 2-8 months. If the interim CEO is a current member of management, then it's important that pay reflects the unique nature of their responsibilities in the interim period but allows a return back to the pay package for the prior position.

Pay for New CEO (Compensation Committee joint with Nominating and Governance): In our experience, the CEO search goes more smoothly if parameters for the incoming CEO's pay package are discussed in advance with the Committee's advisors, and the results shared with the recruiter before candidate selection begins. For instance, determining early on if there are certain annual pay levels the Board is unwilling to go above, or how much the company is willing to pay to buyout a sitting CEO's unvested equity helps narrow the search early and eliminate candidates that may be too expensive.

Running the Business (Interim CEO in close coordination with the Board): The interim CEO should be prepared to align responsibilities or reporting relationships during the interim period to ensure continued execution on a day-to-day basis. For instance, the CFO and General Counsel may take on more external communication responsibilities, business segment reporting may need to shift, or a director may serve as a liaison/coach for the interim CEO. Other pay actions may be appropriate to recognize these shifts in responsibility and to encourage retention (Compensation Committee).

Additional items on the well-prepared Board's checklist include:

- Putting a communications plan in place – both for external stakeholders as well as employees, to reassure the company's stockholders, customers, and suppliers, as well as calm employees in what can be a tumultuous time.
- Develop a separation agreement and release for the CEO. Determine how various pay elements will be treated, and if any exceptions will be made. Providing extra compensation above what is contractually required may be the right approach in some cases, but needs to be balanced with the potential for negative investor feedback and reputation/litigation risk.
- Ensuring that Board and Committee minutes are appropriately documented is critical, but can be overlooked in times of crisis or turmoil. Documenting the Board's activity is an important protection against shareholder lawsuits and helps insulate the Board and company against future issues.

What Boards should do when transition is inevitable

A solid foundation allows the Board to make decisive and sound actions once the decision has been made to transition a CEO. In order to execute on the CEO transition, the Board should:

1. Set an aggressive deadline for the exiting CEO to sign a release. A short window of time to allow for the CEO and his advisors to review the release is reasonable, but it is in everyone's interest to finalize the release and move on as soon as possible.
2. Issue 8-K and press release explaining the exiting CEO's transition, the interim CEO and management structure, and the Board's process for finding a new CEO.
3. Reach out to major shareholders, customers, and suppliers for conversation if necessary. Ensuring business continuity is a critical responsibility of the Board and interim CEO during this time.
4. Establish all-hands employee communications forum. Employee communication should generally align with the company's overall communication approach. If all-hands meetings or town halls are common, then it would be appropriate for the interim CEO, and perhaps Chair of the Board, to hold a short meeting to reassure employees. However, if town halls have not been part of the company's communication approach, holding a town hall may make the CEO transition feel like an even more uncertain and notable event.

When the dust settles

Attention will shift quickly to future programs and the transition and realignment of new CEO integration. Depending on the pay package involved, and whether any significant sign-on awards or increase in annual compensation was required to land the new CEO, it will be important to manage the conversation with shareholders and proxy advisors. The following year’s proxy statement should be forward looking, focused on incoming CEO compensation and the prospective programs and management team, with a complete discussion of the compensation actions taken through the transition period.

The value of up-front planning and the actions outlined above will be evident not only when the time comes to describe the transition in the proxy, but throughout the more difficult periods of the transition process.

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