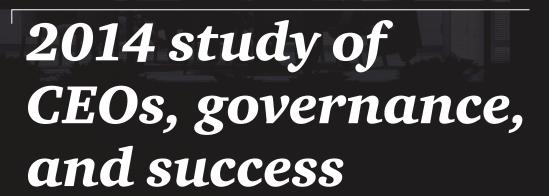
strategy&



The value of getting CEO succession right



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Companies have gotten a lot better at succession planning over the past 15 years—and that's good news, because simply having a turnover at the top, for any reason, depresses companies' performance: the median shareholder return at companies that have changed CEOs falls to -3.5 percent (relative to the index they trade on) in the year after the change.

But too many companies still aren't getting succession planning right. We estimate that at the world's largest public companies just one problem—being forced into turnovers instead of planning them—has recently cost each company in that situation an average of \$1.8 billion in foregone shareholder value.

In our 15th year of studying CEO successions at the 2,500 largest public companies in the world, we've assessed how much progress companies have made toward better succession planning, the value of that improvement, and how much more value some companies are leaving on the table with poor planning.

### What's going right?

- More companies are planning successions instead of forcing them: companies have increased the share of planned turnovers by 30 percent over the course of our study—from 63 percent in 2000–02 to 82 percent in 2012–14. This is a shift from an average of 85 companies in the top 2,500 having forced turnovers each year to 61.
- A clear sign of good planning is a strong internal pipeline: High-performing companies with planned successions are more apt to hire their CEO from inside the company than are other companies, and they follow one insider CEO with another one 82 percent of the time, 9 percentage points more often than low-performing companies.

But companies are still too often forced into making a change, and poorly planned successions tend to lead to a vicious circle:

 27 percent percent of companies undergoing a forced succession hired a CEO from

- outside the company over the past 10 years, compared with 20 percent of those making a planned succession.
- Outsider CEOs have been forced out of office 44 percent more often than insiders over the past 10 years (36 percent of the time compared with 25 percent for insiders).
- CEOs who come in after a forced succession have shorter median tenures than those coming in after a planned succession—only 4.2 years compared with 5.6—meaning that companies without good succession plans are setting themselves up for more frequent turnovers.
- Most often, companies that are already low performers are the ones forced into turnovers and hiring CEOs from the outside—so their poor succession planning tends to increase the degree of change, uncertainty, and sometimes even paralysis inside these companies, and correlates with ongoing low performance and turnovers happening ever faster.

### There is hope:

• If the world's largest companies collectively were able to reach a steady state in which only 10 percent of their turnovers each year were forced, we estimate this could help them add some \$60 billion in shareholder value annually (assuming all else stays the same).

# More and more companies are getting succession right

More and more companies are getting succession planning right. The overall increase in the share of planned turnovers, up to a record high in 2014—86 percent—is one key indicator.<sup>1</sup>

In addition, we see clear correlations between companies with planned turnovers, companies in the top quartile of performance<sup>2</sup> when they do undergo a turnover, and good governance. Over the past 15 years, for example,

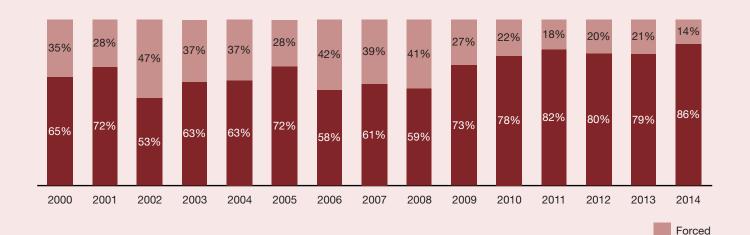
companies in the highest quartile of performance have had planned turnovers 79 percent of the time, compared with 55 percent among companies in the lowest quartile and a 15-year average of 70 percent.

And over the past 10 years, the highestperforming companies have hired 79 percent of their CEOs from the inside compared with 70 percent at the low performers. High performers

Planned

The quartiles of performance used in this analysis are created by dividing all companies with turnovers in a given year into four groups based on the annualized total shareholder returns (TSR) generated by the outgoing CEO over his or her full tenure as CEO relative to the index the company trades on.

### CEO Succession Reasons as a Percentage of Turnover Events 2000-2014



Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A

<sup>&</sup>lt;sup>1</sup> The 2014 breakdown by type of turnover including M&A is 78 percent planned, 13 percent forced, and 9 percent M&A.

<sup>&</sup>lt;sup>2</sup> We state all total shareholder return figures as annualized TSR over outgoing CEOs' total tenure and we regionally adjust the figures, meaning that performance is measured relative to a regional index (S&P 500, Brazil Bovespa, FTSE 100, CAC 40, etc.).

are also able to follow an insider with an insider far more often than other companies: In planned transitions at these companies, 82 percent do so, compared with 73 percent at the low performers, indicating that high performers have generally more robust leadership pipelines.

In addition, insider CEOs are less often forced out of office, have slightly longer tenures than outsiders, and in 10 of the 15 years we've studied have generated higher returns over their time as CEO.

Interestingly, the highest-performing companies also turn over their CEOs more frequently than average performers, with a median tenure of 4.8 years compared with 6.3 years at average performers—but this is far less turnover than among the lowest performers, where the median tenure is only 3.4 years. The relatively speedy turnover rate at the high performers is likely because of poaching—other companies directly hiring these companies' CEOs—combined with companies planning a change to keep ahead of the game and ensure they have the talent they need for the future.

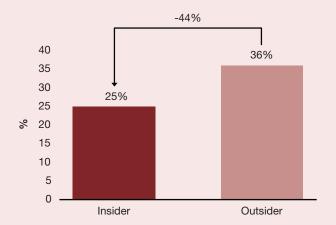
Top-performing companies have boards that make CEO governance and succession an ongoing agenda item at board meetings, and they hold executive sessions (without the CEO) on the topic. They can typically get in front of issues before they become disruptive, so they reduce the chances of a forced succession event.

Ken Favaro

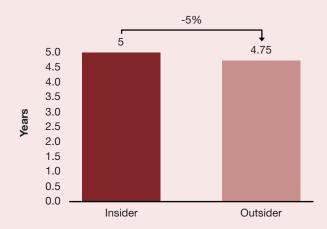


### Some Advantages of Insider CEOs, 2005-2014

Forced turnovers – Insider vs outsider status of outgoing CEO



Median tenure of outgoing CEOs



Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A, interims, and events with incomplete turnover information.

# The vicious circle some companies still fall into

Too often, the lowest-performing companies are also the ones that get succession planning wrong, as we see it. They far more often have a forced turnover—indeed, 40 percent of all forced turnovers have taken place at companies in the lowest quartile over the 15 years we've studied the patterns. In many cases low performance gives a board good cause to force out a CEO—indeed, shareholder returns in the year after a forced turnover improve from a median of -13 percent to -0.6 percent at these companies (relative to their indices). Even so the share of forced turnovers is higher than we

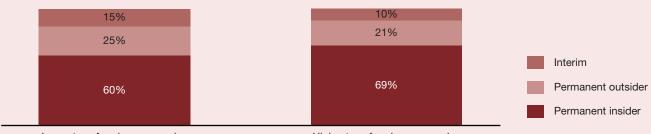
think it should be, and when they do occur the outcomes could be improved.

In addition, the lowest-performing companies don't appear to have as strong a pipeline to call on: Over the past 10 years, 25 percent of their new CEOs have been outsiders and an additional 15 percent interim leaders, compared with 21 percent and 10 percent at the top performers. The lowest-performing companies are also least often able to follow an insider CEO with another insider.

It's important to remember that forced turnovers aren't always the wrong choice—surprises happen to the best-run companies and sometimes a board simply needs to make a change for the overall good of the company. Even so, our experience suggests that having a solid plan will help a company stabilize sooner after any kind of turnover.

Gary L. Neilson

### More Interim and Outsider CEOs at the Lowest-Performing Companies



Lowest-performing companies

Highest-performing companies

Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A, and events with incomplete turnover information.

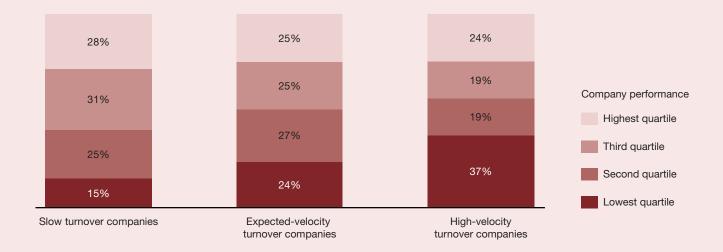
Forty percent of all the lowest-performing companies face additional uncertainty whenever they have a change at the top, because either they have a CEO they don't know at all or they have a CEO whose role is designed to be temporary. Such uncertainty tends to reduce morale and corporate performance.

Per-Ola Karlsson

The pipeline concern is made worse by the fact that the lowest-performing companies tend to have more turnovers than others. Among the companies that have had four or more CEO turnovers in the 15 years of our study, the company's annualized relative TSR over the tenure of the outgoing CEO puts 37 percent of

them in the lowest performing group at the time of a turnover; this compares with only 15 percent at companies that have had only one turnover in that period. Furthermore, 31 percent of all turnovers among companies that had at least four were forced, compared with 21 percent at companies with only one turnover.

## Company Distribution by Number of Turnovers and Quartile of Performance 2000-2014



Source: Strategy& analysis

Note: Our analysis of turnover velocity is based on the median CEO tenure of five years and the fact that our database now contains 15 years of data. "Expected-velocity turnover companies" have had two or three CEO changes in the course of our study and the other categories have had fewer ("slow") or more ("high-velocity").

### \$112 billion in foregone value

Any kind of CEO turnover results in shifts in the top team, changing corporate priorities, and an inward focus at most companies. These are likely among the reasons that we see a drop in total shareholder returns in the year leading up to a CEO turnover as well as the year after it. In the preceding year, median TSR (relative to companies' indices) falls to -2.3 percent, and it falls again, to -3.5 percent, in the year after.

There's a stark difference between companies able to plan their turnovers and those forced into them: at companies forced into turnovers the median TSR in the year before the change falls to -13 percent, while it drops, but only to -0.5 percent, at companies with planned turnovers. In

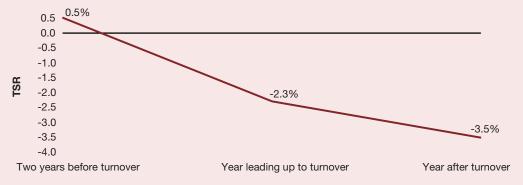
the year following the turnover, companies with forced turnovers recover somewhat, to a median TSR of -0.6 percent, while those in planned turnovers see another drop, to -3.5 percent. In recent years, we estimate, all this means companies undergoing forced turnovers have foregone some \$112 billion a year<sup>3</sup>—that's roughly \$1.8 billion for each company.

There is good news: if companies continue the trend toward more planned CEO changes, to the point that they reduce the share of forced turnovers to 10 percent, we estimate that they could collectively generate an additional \$60 billion in value (all else staying the same).

Given the value implications, this is clearly a business issue that needs to be 'owned' by the top team instead of being relegated to HR. There are a few straightforward ways to start. First, boards need to take responsibility for the succession process, not just for the next CEO but to build a robust, sustainable executive pipeline. Second, boards should always have a plan for succession, though they should keep it private to avoid executives' leaving the company. Third, executive HR processes should reward managers who contribute to the development of talent and discourage parochial, protective moves that prevent high-potential talent from gaining experience across the company.

Gary L. Neilson

### Median Total Shareholder Return in the Turnover Window 2011-2013



Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A, interims, and events with incomplete turnover information.

<sup>&</sup>lt;sup>3</sup> This analysis is based on turnovers occurring in 2011, 2012, and 2013 for which full turnover and market capitalization information are available.

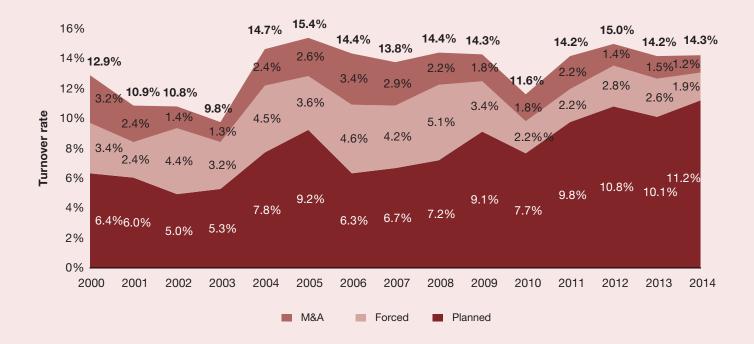
### 2014's incoming class

We continue every year to examine the incoming and outgoing CEOs among the 2,500 largest public companies in the world because determining what companies do at these critical turning points helps us understand what they are looking for in a CEO and how the role is changing. In 2014, we saw almost the same number of turnovers as in the previous year, but the reasons shifted a bit.

This year's incoming class of CEOs was also similar to those in recent years, once again highlighting that on the whole, companies hire CEOs who are familiar to them in many ways—mostly insiders, mostly from the same country as their company headquarters location, mostly having worked only in the same region as their company, and mostly having joined their company from another in the same industry.

### CEO Turnover Rate by Succession Reason

CEO turnover events as a percentage of top 2,500 public companies

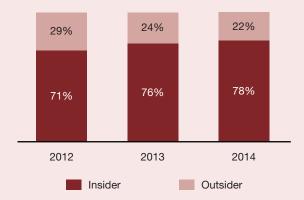


Source: Strategy& analysis

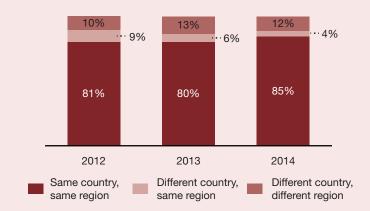
Note: All figures may not add to totals because of rounding

# Incoming CEOs 2012-2014

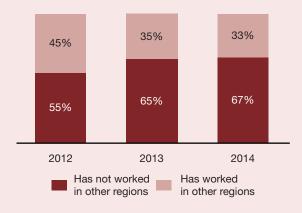
### By insider vs outsider status



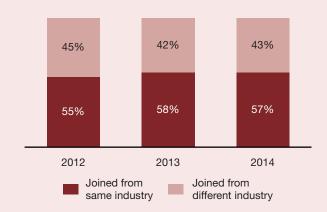
### By nationality compared to company HQ region



# By previous experience in different region compared to company HQ region



## By same or different prior industry compared to current company industry



Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A, interims, and events with incomplete turnover information.

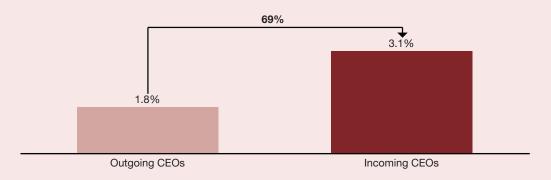
It's notable that over the past five years the highest-performing companies have far more often than others hired a CEO who comes from a different region than the company headquarters

location—overall, 17 percent of CEOs at high performers have been from a different region, compared with 11 percent at the lowest performers.

Ont all talent in a company comes from the same country as company headquarters, of course. When choosing a CEO, high-performing companies may place more emphasis on understanding other markets—which can be crucial to growth—than on familiarity at headquarters.

Per-Ola Karlsson

Percentage of Women CEOs by Incoming and Outgoing Classes 2004-2014



Source: Strategy& analysis

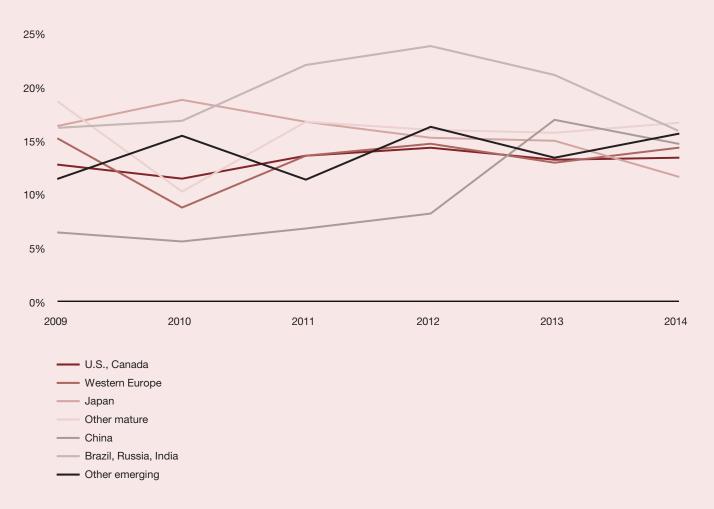
There were 17 women in the 2014 class of incoming CEOs, or 5 percent of all new CEOs (compared with 3 percent in 2013). This continues the trend we observed in last year's study of a slowly increasing share of women CEOs. We saw no meaningful change in our two most

startling findings about women CEOs—that they are more often outsiders (33 percent over the 11 years from 2004 through 2014 compared with 22 percent of men) and more often forced out (32 percent of the time over 11 years compared with 25 percent of men).

The share of women CEOs is still pathetically low, but the trends we see should have a meaningful effect over time. By 2040, we expect a third of all incoming CEOs to be women.
Ken Favaro

## Regional and Industry Trends in CEO Turnovers

2009-2014 CEO turnover events as a percentage of top 2,500 public companies in each region



Source: Strategy& analysis

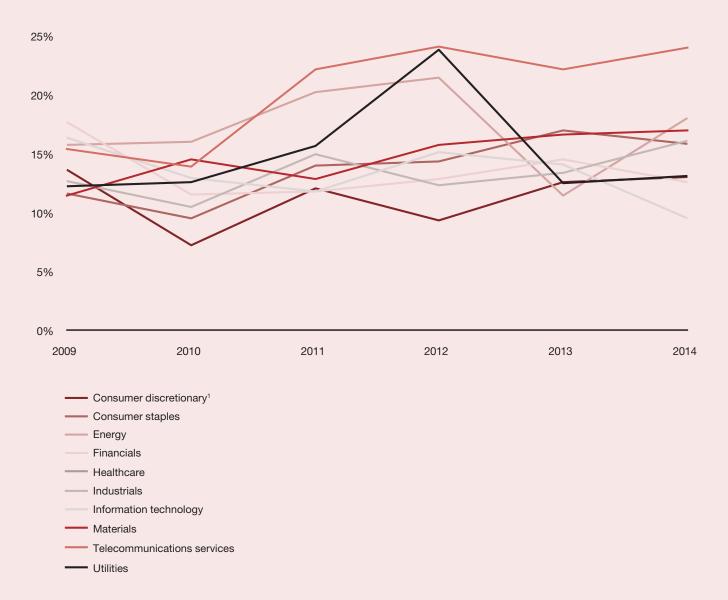
Note: "Mature" countries are defined as per the U.N. Development Programme 2013 ranking of countries with "very high human development" (human development index >0.8); all others are "emerging" countries.

Over time, turnover rates across regions seem to be converging, suggesting that companies are increasingly facing similar dynamics around the world. Gary L. Neilson

<sup>&</sup>lt;sup>1</sup> "Other mature" economies include Argentina, Australia, Bahrain, Chile, Cyprus, Czech Republic, Hong Kong, Hungary, New Zealand, Poland, Saudi Arabia, South Korea, etc.

<sup>&</sup>lt;sup>2</sup> "Other emerging" economies include Colombia, Egypt, Indonesia, Kazakhstan, Mauritius, Mexico, Mongolia, Nigeria, South Africa, Turkey, etc.

# 2009-2014 CEO turnover events as a percentage of top 2,500 public companies in each industry



Source: Strategy& analysis

Note: These figures may differ from those reported in earlier years because companies in the healthcare industry are now reported separately

<sup>&</sup>lt;sup>1</sup> "Consumer discretionary" includes automobiles and components, consumer durables and apparel, consumer services, media, and retailing.

### Methodology

This study of CEOs, Governance, and Success identified the world's 2,500 largest public companies, defined by their market capitalization (from Bloomberg) on January 1, 2014. We then identified the companies among the top 2,500 that had experienced a chief executive succession event between January 1, 2014, and December 31, 2014, and cross-checked data using a wide variety of printed and electronic sources in many languages. For a listing of companies that had been acquired or merged in 2014, we also used Bloomberg.

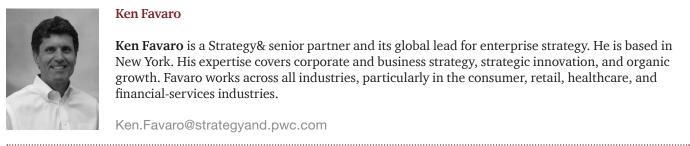
Each company that appeared to have changed its CEO was investigated for confirmation that a change occurred in 2014, and additional details—title, tenure, chairmanship, nationality, professional experience, and so on—were sought on both the outgoing and incoming chief executives (as well as any interim chief executives).

Company-provided information was acceptable for most data elements except the reason for the succession. Outside press reports and other independent sources were used to confirm the reason for an executive's departure. Finally, Strategy& consultants worldwide separately validated each succession event as part of the effort to learn the reason for specific CEO changes in their region.

To distinguish between mature and emerging economies, Strategy& followed the United Nations Development Programme 2013 ranking.

Total shareholder return data over a CEO's tenure was sourced from Bloomberg and includes reinvestment of dividends (if any). Total shareholder return data was then regionally market-adjusted (measured as the difference between the company's return and the return of the main regional index over the same time period) and annualized.

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