

THE DIRECTOR'S GUIDE

To  
CEO Succession

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NACD Directorship

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The Director's Guide to CEO Succession



# Nothing Succeeds Like Succession

CEO succession planning is widely acknowledged to be one of the board's key responsibilities, a point driven home in recent years by one governance expert after another. Yet, it is a fact of corporate life that a thorough and well-considered CEO succession process is still not being implemented in as rigorous and reliable a fashion as it should be at many companies.

But the Securities and Exchange Commission (SEC) Staff Bulletin—No. 14E (CF) to be precise—issued late last year may prove to be the game-changer required to elevate CEO succession planning to the position it deserves on the board's list of priorities.

According to this guidance from the SEC, succession is no longer considered part of “ordinary business matters,” the details of which the board does not have to disclose. Instead, succession is now recognized as a fundamental duty, and part of the larger risk-management picture, with serious repercussions if it is not handled correctly. Further, the bulletin recommends greater transparency and shareholder disclosure about the management of succession risk “so that the company is not adversely affected due to a vacancy in leadership.” With access to this board-performance metric, how well boards handle succession is now increasingly a criterion that the investment community will have access to as they evaluate boards.

## Addressing the Disconnect

According to Korn/Ferry International's 34th Annual Board of Directors Study of *Fortune* 1000 organizations, 84 percent of directors surveyed believe the importance of having a CEO succession plan has increased, but only about half actually have one in place. Why the disconnect and, more importantly, what can be done to resolve it?

This sizable gap between awareness of the importance of succession planning and follow-through did not come as a great surprise to us. Our day-to-day

conversations with CEOs and directors reinforce the fact that they get it: Succession planning is crucial; it will now be subject to greater outside scrutiny; adhering to best practices will protect the company's reputation and value; and the board will be able to defend key leadership decisions, if need be, with solid data.

But the roadblock to implementation of succession planning persists on many boards, a result of several factors that must be addressed, including:

**HABIT** Succession at most companies was traditionally a process managed mainly by the CEO, with little involvement from the board.

**HUMAN NATURE** Succession entails dealing with real psychological factors, such as confronting one's mortality and sensitive leadership choices where there are perceived “winners” and “losers.”

**HOW-TO?** Boards may not know where to start, what best practices are and how they can learn from boards that do it well.

Now is the time to take action and overcome whatever is standing in the way of implementing a succession practice. Because there is more than one approach, each succession plan needs to be thoughtfully adapted to a particular company and its board.

## Start With a Vision

Effective succession planning starts with a mindset, rather than a checklist. It's not simply about finding someone to replace the CEO, though that is of critical importance. Best-in-class boards start with a broad vision of succession and specific goals that stretch well beyond the boundaries of the corner office.

Properly implemented, succession is an ongoing leadership development process in which CEO succession is a subset. It is designed to provide talent options for key leadership positions at every level. Companies that achieve this goal not only score points in governance and investor circles, they attract the best talent when they become known as academies of leadership development.

Adhering to best practices will protect reputation and value.

By Joe Griesedieck

Boards that master succession planning don't have to worry about the prospect of a leadership crisis that could derail plans and progress, subject them to public criticism and potentially have long-term, negative repercussions for the company and shareholder value. They can instead focus on their business assured that regardless of circumstances—an emergency replacement required, short-timed departure or planned retirement—the bases are covered.

When the objective is to establish a world-class succession process, boards must first make succession a priority in word and deed. That means ensuring that succession-related discussions are on the board's agenda at least once a quarter and, ideally and increasingly with many boards, at every board meeting. Because succession and leadership development, generally, are such complex, multi-faceted topics, board meetings often don't provide adequate time to examine and discuss succession thoroughly. That is why most leading boards now have an annual or semi-annual off-site meeting devoted to succession discussions, much the way boards have focused on strategy.

### Strategic Alignment

To design and implement a succession process that ensures the most capable leadership is guiding the company, the place to start is with the strategy. Aligning directors on the strategy is an important first step because succession, specifically the key competencies—and their order of priority—that will be required in the leadership team are driven by the strategy. A company guided by a strategy that details growth by acquisitions, for example, will seek very different qualities in a CEO than a company determined to focus on growing existing businesses. The former will seek a future CEO with M&A experience, including post-merger integration, while the latter will emphasize industry-specific experience and a successful track-record running operations.

One word of caution: Never assume that a future CEO will be a carbon copy of the current CEO, no matter how effective a leader he or she has been. The key is to peer into the future via the strategy and create a profile for the CEO who will be best equipped to implement it.

In our experience, it is not unusual for directors on the same board to hold widely differing views of the strategy and what the company should focus on. An important part of the process is assessing where these views diverge and align, so that directors can come together as a team with a shared view of where

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the company is headed, as well as the resources required to get them there. Succession, like strategy, is forward-looking and dynamic. Shifts in the strategy resulting from changes in market conditions, economic factors, political circumstances, and a host of other variables, may necessitate

shifts in the leadership competencies required.

### Addressing Human Nature

Effective succession planning requires continual conversation and collaboration between the board and the CEO. Institutionalizing the process so it is regularly an agenda item enables the board to stay ahead of changing conditions that may affect the standing of potential candidates on a priority list. In addition, revisiting succession routinely will lessen some of the “human nature” concerns that can hinder succession planning, such as associations with mortality and internal competition. Handling succession in a transparent, matter-of-fact fashion—using a process that is perceived by all as fair—can ameliorate the personal sting felt by those being assessed. And establishing succession as a crucial but routine matter obviates the need for “the big talk” among directors and the CEO, increasing everyone's focus and comfort level.

There are a couple of key areas in succession planning where it is wise, indeed considered a best practice, to engage a third party to work with the board.

One area in which outside, expert counsel is valuable is in helping the board to coalesce as a team around the strategy, which is crucial to effective succession planning and all of the work the board needs to accomplish as a close-knit group. Involving consultants experienced in assessing individual director views, highlighting areas of agreement and disagreement, and facilitating productive discussion on crucial areas of concern will help ensure that the board is focused on the right work at the right level and using its valuable time to good advantage. Concerns or questions about the strategy are far better aired in the appropriate forum, when they can be safely dealt with, than while making an important decision under time constraints, when differences can lead to a divided board and poor choices.

Partnering with a third party for the succession-planning process itself is also an established best practice with distinct advantages, akin to a governance “seal of approval.” With what was once considered the board’s own business now open for all to see, third-party involvement—including exposure to best practices—helps ensure a rigorous, objective process. This will be increasingly important to boards as the shareholder community evaluates how well succession planning is handled and adds that metric to other investment criteria. And in the event that leadership choices are challenged, boards will have the data to establish that they followed the right steps in executing the succession process.

Also critical, particularly to retain inside talent, is the perception that the process is fair and transparent at every turn. Even those who may be unhappy at being passed over for a desirable leadership position are more likely to accept decisions emerging from a process that they perceive as objective and based on fair selection criteria—and less likely to head for the exit.

#### Pull and Push

Developing and retaining talent—the leadership pipeline—is a critical element of the leadership development process. Hiring talent from the outside is always the back-up choice, unless the company is facing major change (such as a vastly different strategy or significant shifts in its industry) and those in

line for succession do not possess needed skills and experience. Even when insiders top the list of successors, however, gaining an outside perspective is crucial to developing the best talent and making the best choices.

Leading boards often gain that external view with the help of a third party who can provide a deep and broad perspective across industries on best practices for succession. A third party will craft a benchmarking process that can be difficult for companies to undertake on their own on a regular basis. Benchmarking data enables companies to assess their own talent against the best outside talent, employing whatever screens they wish, including industry, company size and others. The benchmarking data can also serve as a useful check on succession planning, suggesting gaps in candidates’ skills and experience that will need to be filled if they are to succeed to particular positions.

Boards are increasingly feeling the push-pull of implementing a thoughtfully designed, well-executed succession process. The push? The ability of the investing public to now view and “grade” a process which, if there even was one, was historically handled behind closed doors. No board wants to be scrutinized only to come up short and be exposed as lacking in the leadership development arena. Ensuring a steady flow of capable leadership is essential and safeguards a company’s future by quelling any investor uncertainty about proper stewardship.

But the pull is just as important as the push. More boards are now focused on succession planning, not just because they have to do it, but because they recognize the advantages they gain, long-term, when they get it right. Demonstrating a rigorous succession process, based on established best practices, can have a positive impact on company reputation and value. That can translate into elevating the company’s status as a desirable place to invest as well as an attractive place for talented people to build a career. **D**



Joe Griesedieck is vice chairman and managing director of Board and CEO Services at Korn/Ferry International.

## The Ins and Outs of Successful CEO Transitions

The best candidates come from within and the board's knowledge of them in roles outside the boardroom.

*A distinguished panel of directors and Korn/Ferry International executives discussed the strategies boards should employ and avoid when instilling a CEO succession plan for their company. Of course, tactics vary depending on company size, structure and industry and our panel covers that spectrum. NACD Directorship President and Publisher Christopher Y. Clark moderated the discussion. What follows are highlights.*

**NACD Directorship: How does a board create the right CEO succession process—what should boards enact and avoid?**



Bonnie Hill

Joe Griesedieck: We encourage boards to try to look internally for successors. Don't go outside if you don't have to. It's more risky. Sometimes it's necessary, but for the most part, if boards get out in front of this three or four years in advance, most often they can get to know the internal candidates a lot better than they know them today.

Richard Daly: The first thing I did was poll individual directors and ask them if they could share with

me a time when they felt good at the end of a succession process. None could say that they participated in a succession process that they felt really good about. At Broadridge, I brought an external advisor in, not to run a CEO succession process, but to advise us on what a good process would look like. With the benefit of outsiders, we ranked the talent we had. I went through all the testing and shared the results with every leader tested and the entire board. We were able to see what we look like right now with complete transparency between management and the board.

Margaret Foran: You can't just import something and think it's going to work for your organization.



Richard J. Daly

You've got a different board with different experiences, so you're going in a different direction. The process really has to be tailored from the very beginning. I think it's critical to continually have those conversations early on.

Bonnie Hill: I agree that having internal candidates for CEO succession is preferable, but if there are no internal candidates, hiring individuals who can be future candidates is one strategy. If the board



Ilene Lang



Kenneth Kopelman

does not see viable candidates that can step in on an emergency basis, that's a concern and there need to be some internal changes.

***NACD Directorship: How should a board approach the succession process?***

Nels Olson: There are boards that look at CEO succession as a singular event, but should look at it more holistically. Most likely, the successor is internal, which means you have a position that's going to be open on the senior team. You have to look at not just the CEO, but down a rung or two.

Phillip Lochner: Boards tend to defer to successful CEOs and successful CEOs tend to dominate the process. I think boards sometimes fail to ask whether the CEO's recommendation is really the right person to lead the company forward. I'm a big believer in going outside and benchmarking—even if you have viable internal candidates.

Robert Friedman: I think it is less about CEO succession than it really is about understanding the package of management. It's not about an individual, particularly depending on the category.

Hill: If a CEO can give you only one potential successor, that in and of itself is a challenge. One plan for developing successors is to alternate them through different senior-level positions—I've seen it work. It doesn't work each time, but the process gives the management team a more well-rounded experience.

Daly: Picking a CEO, and then succession for the CEO, are jobs one and two for boards. Bringing [outside] professionals in not only gets the board to a comfort level that they deserve to be at, but they also can check the boxes with brutal candor and transparency.

***NACD Directorship: How can a board reach out beyond board meetings?***

Hill: At Home Depot, we've structured dinners around specific departments. For example, we may have the marketing team for dinner and one or two directors at each table. The discussion at each table is different; however, the subject matter is marketing. Having the board interface with associates from within the same department provides good feedback for board discussions, as well as a deeper understanding of the department involved.

Kenneth Kopelman: The day before every board meeting, in the 60 minutes after committee meetings are done but before the board dinner starts, each of our directors sits down for a one-on-one with a senior person. These sessions are completely unscripted, with no agenda, no PowerPoint, nothing. Within the space of a year, each director gets to meet six to eight senior managers, who may one day be part of the CEO succession plan, in a fairly intimate way. Watching an executive or a team present inside the boardroom—when the full board and the CEO are there—can be a lot different than sitting in their office, with no required subject matter, no agenda. It

can be very high-quality time in terms of sizing them up and getting to know them.

**NACD Directorship: How should boards manage second- and third-choice candidates?**

Ann Reynolds: When it's a horse race for the CEOship, two or three top-performing people in the company are told that, depending on how they perform and how they interview with the board, one of them will be anointed. Having experienced it, this is truly a horrible process, and should never be repeated, if at all possible.

Foran: It may work in companies such as GE where you have separate businesses and people are really not interacting. If you've got one business, there are some major challenges.

Steve Mader: It creates winners and losers in the eyes of the rest of the organization as well. So everybody's watching the competition, it's a pronounced competition and it's an announced competition.

**NACD Directorship: How does age play into selecting a candidate?**

Lochner: If the person is put into the CEO's job at say, age 50, their personality isn't going to change, their skill set isn't going to change by much. So it's a matter of understanding that at the outset and then

being able to fill in if somebody's not strong on the financial side. Maybe you need a better CFO. It's a package deal in some sense.

Reynolds: You generally don't get the exact date that he or she will retire—even if they are a competent CEO—because the minute they announce that, they start to feel their power dissipate. So you've got this timing difficulty, and if people are aspiring to the CEOship, and some of them are very good, you want to hold onto them.

**NACD Directorship: How should directors perceive their efforts in planning for a successor?**

Reynolds: What's necessary is a great deal of patience and a back-and-forth exchange between board members that has its grounding in the fact that you have tried really hard over the years to relate to fellow board members, so you have respect for them.

Ilene Lang: Companies should not be on hold, waiting for the board meeting when the decision [on succession] is to be made. We've seen recent examples where company transitions were smoother because there was transparency. The lesson here is that the company benefits from a collaborative process, not an internal competitive one with a winner-takes-all and a losers-totally-out mindset. **D**

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# Expect the Unexpected Before the Crisis Calls

In considering an overall succession plan for a company and the relationship of that plan to the company's strategic needs, it is often easy to forget about the potential for significant unexpected events that could alter the make-up of management overnight and have a profound effect on the company's short-term valuation and long-term plans. As a result, an emergency-succession plan remains a critical component of any company's overall management-succession process. While not all public companies have implemented emergency-succession plans, the implementation of such plans appears to be on the rise.

The principal purpose of an emergency-succession plan is to ensure that decisions about successor appointments are made in advance of a significant unexpected event, such as the severe illness, death, resignation or termination of the chief executive officer or other critical members of senior management. Given the potential that these unexpected events could have an adverse impact on a company's stock price, ongoing operations and short-term and long-term prospects, the board of directors should consider establishing defined lines of succession that can be quickly implemented and publicly disclosed when necessary.

## Emergency vs. Long Term

An emergency succession plan may be markedly different from the company's long-term succession plan—for example, different executive officers or directors may be tapped to succeed a chief executive officer or other executive officers on an interim basis, because an effective emergency-succession plan is designed to assure a seamless transition of management during a crisis situation, rather than seeking to meet long-term strategic objectives. As a result, the board of directors should carefully consider the design and operation of an effective emergency-succession plan well in advance of ever needing to implement the plan, and the board should then review the plan at least annually and more frequently when there is an orderly change in management or in the event of some significant event (e.g., the diag-

nosis of a chief executive officer's serious illness). Several key features of effective emergency-succession plans include:

- Responsibility for the emergency-succession plan is often vested with a committee of the board, such as the compensation committee or the nominating and corporate governance committee. While the committee is deemed responsible for the plan, the full board should remain responsible for any appointments (including permanent or interim appointments) that are made.

- An effective emergency-succession plan contemplates not only succession in the event of unexpected events such as death, disability and resignation or removal, but also succession in the event of temporary, unplanned absences (which may be defined as exceeding a specific time period, e.g., six months), such as when an individual expects to be out of the office on an extended basis, for example, due to a treatable illness.

- A plan may provide that, unless otherwise specified by the board of directors, all appointments will be made on an interim basis, so as to preserve the flexibility for the board of directors to make permanent appointments at the time of the unexpected event, particularly in situations where the established lines of succession are consistent with long-term succession plans.

- A plan should provide that appointments made by the board of directors occur within a very short time period in order to minimize the amount of uncertainty associated with the succession event. A time period of two business days after the appropriate committee receives notice of the unexpected event may be reasonable, although a longer or shorter period may be appropriate, depending on a company's individual circumstances.

Generally, plans will afford the board discretion to ascertain the term of service for any interim appointees, the scope of authority of successors, and the compensation for successors under the emergency-succession plan and other company policies.

An emergency plan may be very different than what's needed long term.

By David M. Lynn

In this regard, the board should consider when implementing an emergency-succession plan what other policies could be triggered by an unexpected event, and how those policies would work together with the succession plan.

While many plans focus on the succession of the CEO, it may also be appropriate to provide in the plan for the succession of other executive officers, particularly when other specified executive officers (such as the president or CFO) are slated to succeed the individual serving as the chief executive.

To preserve maximum flexibility upon the occur-

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For maximum flexibility, identify two or three executive officers as successors, to address the potential that more than one executive officer could be subject to the unexpected occurrence at one time.

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rence of a significant unexpected event, it is often appropriate to identify two or three executive officers as successors, to address the potential that more than one executive officer could be subject to the unexpected occurrence at one time.

### Being Flexible

While an effective emergency-succession plan is designed to provide an important level of certainty for the board of directors when a crisis arises, it is critically important that the board preserve flexibility to adapt its actions with respect to management succession to the particular situation that the board faces at the time of crisis.

Even with an emergency-succession plan in place, the board of directors will need to look at the overall circumstances arising in connection with the unexpected event, and should carefully consider the planned succession. For example, a board could be forced to terminate a CEO due to an indictment; the emergency-succession plan provides that the CFO is the CEO's designated succes-

sor. Based on potential concerns that the CFO could be involved in the same conduct that gave rise to the CEO's indictment and termination, the board may need to identify another replacement outside of the succession plan to avoid any potential adverse legal or other consequences in connection with the appointment.

### What the Public Should Know

It is recommended that an emergency-succession plan remain confidential, with access limited to the board and only those employees who have a need to know in the event of an unexpected event. While there is no requirement to publicly disclose the terms of an emergency-succession plan, a company may want to consider revising its corporate governance guidelines and proxy-statement disclosures (if any) to note the existence of the plan, so investors can be assured that the board is attentive to this critical issue.

Upon the occurrence of an unexpected event and the appointment of a successor under the plan, the change in CEO and the change in any other specified senior officers would need to be disclosed quickly by filing a Form 8-K with the Securities and Exchange Commission. Companies may also want to issue a press release or conduct a conference call to address the unexpected event and the related management succession, considering any potential Regulation FD and investor-relations concerns.

An effective emergency-succession plan is necessary to avoid the potential confusion and delay that can result when an unexpected event forces a change in management. While a company could adopt a standalone emergency-succession plan, it is best to consider emergency-succession issues in the context of the company's overall consideration of management succession.

Once an effective plan is in place, the board must be ready to quickly and carefully evaluate the circumstances around the unexpected occurrence to determine whether the pre-established succession plan remains in the best interests of the company and its shareholders.



David Lynn is a co-chair of Morrison Foerster's Public Companies and Securities Practice in Washington, D.C.

# Overcoming Resistance to Succession

Nels Olson offers sage advice for boards seeking an effective CEO succession plan of action.

*Let's consider a number of different scenarios common to board practice, starting with a new company and new board—presumably this would be a fresh start with a clean slate. From your perspective, is this the ideal situation?*

Nels Olson: In this day and age, given the scrutiny boards are subjected to, it comes down to good governance: making sure you have the right representation, the right financial expert and appropriate comp and audit chairs. It's imperative that you have succession planning in place from day one. This is something we emphasize in the conversations we have with our clients. I'm working on a board project right now for a pre-IPO company. We are discussing not only the board make-up, but other issues they should have in mind. A CEO succession strategy is front and center.

**Scenario #2: *What about an entrenched CEO, perhaps a founder, who is resistant to any mention of a successor?***

This is the trickiest scenario of them all. It really comes down to the lead director having a discreet conversation, away from the rest of the board, with the sitting CEO, stressing the importance of succession planning, and frankly showing some examples of some that haven't gone well. It is important to discuss SEC Bulletin Section 14E and the financial-regulation rule about transparency and succession planning and the need to have a plan in place. There are enough things out there that could be a catalyst to the conversation, which were very difficult in the past, and a little fear can be a powerful motivator.

**Scenario #3: *The distracted board: With so many short-term issues, particularly during an economic downturn, how should the board prioritize longer-term issues?***



Nels Olson is managing director, Eastern Region, for Korn/Ferry International and senior client partner with the Board & CEO Services practice.

Every company has a significant number of issues that it is dealing with at any given board meeting. I think it's up to the lead director or the head of the nominating committee to make sure succession is at the top of the agenda, and that periodic off-site meetings are planned to focus exclusively on succession. Succession planning and picking the chief executive is the number-one job of the board. Regardless of all other issues that are in front of a board at any given time, making sure there is a plan in place is critical. There's not nearly as much push back as there had been in the past about this because directors recognize the importance of succession.

**Scenario #4: *The inert or complacent board that believes its longstanding succession plan is sound: How do you test your current plan and how often is sufficient?***

You need to make sure that your succession plan is revisited at least on an annual basis and that you have an up-to-date game plan, which anticipates common scenarios. In many cases, you need to review your current strategy at least twice a year. So the nominating committee has to make it part of its agenda and use board meetings as an opportunity to get to know the other potential internal candidates. Directors need to be exposed to potential candidates both at the board meetings and outside of them, whether it's through presentations or special assignments given to them, as well as social situations. These interactions allow for a broader perspective on those candidates and allows the board to get to know some of the potential candidates.

**Scenario #5: *The stricken CEO: What's the best interim solution if no succession plan is in place?***

The most likely scenario is you have an interim person, whether that's the chairman of the board or someone on the senior team who could step in while this is being examined, but it's most useful to use someone during this traumatic situation who has some familiarity with the company, is respected and will have a firm hand on the tiller. It's common for the chairman to step in while a search is being conducted. The chief concern is to ensure that the company is communicating to the investment community that the board did not drop the ball and strong, capable leadership is in place.

# Executive Compensation Programs Can Help or Hurt CEO Succession

By Matt Turner

While executive compensation is never the primary factor in an orderly and successful change of leadership, there are aspects of compensation philosophy and policy that can significantly help or hinder the process, including:

- The relationship of CEO pay to compensation for other named executive officers (NEOs)
- Compensation for likely internal CEO candidates before and after succession

## Keeping CEO and NEO Pay Proportionate

There has been a lot of discussion in activist circles regarding the proper ratio of CEO compensation to that of the average worker, to the #2 executive or to the other NEOs. It has been argued that when CEO pay is stratified above the rest of the executive team, it leads to dysfunction and inefficiency at shareholder expense. Critics further maintain that a disproportionate pay relationship among corporate leaders is unfair and a likely symptom of poor governance. While such concerns are in part social-minded, they are relevant to CEO succession.

The gap between the pay of the CEO and other NEOs varies by industry and other circumstances related to talent strategy. For example, CEOs of broadcast and retail companies usually have annualized pay packages that, when the value of equity grants is included, may be three to four times higher than those of other NEOs. Acquisitive companies and others engaged in a high level of strategic transactions may also have very highly paid CEOs relative to other top managers. Founder CEOs also can have high pay levels. In some cases, very high levels of performance of the CEO can justify such pay disparity. Does “rock star” industry talent really get more deals made and doors opened? Possibly. But whether true or not, such a compensation model presents a serious dilemma in terms of succession planning.

Stratified pay may occur because the CEO is paid extremely well against the market, or because the

other NEOs are paid relatively poorly, or a combination of both. When the other NEOs are paid below-market, chances are the board has come to overly rely on the incumbent CEO to run the company and has allowed key operational and functional decision making normally vested in other NEOs to be controlled by the CEO.

The likelihood of an internal succession in such a scenario is lower. It will be difficult for any other senior officer to function at the level of the highly controlling incumbent or to reassure external stakeholders that company stewardship will be transferred with calm and continuity. Because the “switching cost” for CEO succession will be relatively high, the board may give further deference to the incumbent CEO and exacerbate the pay stratification.

Sooner or later, organizations in these circumstances will face serious consequences. In one extreme example, the founder/CEO of a small-cap information-services company was paid in the top decile of the market, while every other key C-suite officer was paid near the bottom quartile. Moreover, the CEO's recent self-evaluation focused on his hands-on leadership in key marketing initiatives, his personal involvement in executing a recent acquisition and his indispensable role in securing a large-client relationship. The compensation committee, after years of acquiescence in this unbalanced leadership model, finally realized its predicament – that the CEO was effectively serving the roles of chief marketing officer, chief financial officer and top salesman.

## Compensation for Internal Candidates

Along with the negative impact of stratified CEO pay on the readiness of internal candidates, promoting a “tournament” approach to executive succession hurts retention of top candidates because their career success is increasingly defined by the pursuit of the chief executive's office. Not attaining that

office is seen as failure, or at least a critical stumble in their career progression. In such circumstances, worthy candidates are more likely to pursue outside job opportunities.

Companies can increase the likelihood of holding key talent through a leadership transition by taking a proactive approach to executive compensation, including the following actions: First, ensure that NEOs are paid not only appropriately against the market, but consistent with internal equity considerations. In other words, the company should generously compensate long-tenured executives who have proven they are truly exceptional in their roles, or are key “utility” players who ably fill varied roles as needed. During a period of stable CEO leadership and low executive turnover, boards may assume these executives really don’t need to be paid so well. But taking a proactive approach that calls for fair, and not just required, compensation can make a big difference in the response of an internal CEO candidate who ends up a runner-up.

Recruiters will confirm that dissatisfaction with level of pay is rarely the primary reason that senior executives leave a company—it is just symptomatic of other issues. When executives believe their value is truly recognized (not just with compensation, but by increasing board interaction, new leadership responsibilities, etc), they are less likely to view getting the CEO’s job as the only worthwhile step in their career. Throwing a lot of money at a CEO runner-up after the fact will be quite costly and ultimately will not improve the likelihood of long-term retention under new leadership. In fact, this action may just delay turnover, be more costly to the company in the interim and potentially create a difficult CEO transition.

Second, impose a stiff price for voluntary separation. That can be done by tying up more of total executive compensation in long-term incentives with extended vesting requirements (e.g., four or five years). Additionally, ensure that long-term insurance policy cycles overlap, keeping a perpetual payout opportunity just “over the horizon.” Once it is clear which internal candidates will not be getting the top job, act proactively—before the succession decision is public—and consider providing special recognition grants of equity with long-term vesting to runners-up.

It should be noted that these actions assume it is in the company’s interest to retain the runners-up. Naturally, any good succession plan must contemplate leadership dynamics and operational needs. If a high-performing executive is passed over and the board does not believe this executive could effectively perform under the new CEO, the board should not be afraid to effectuate an orderly and amicable departure.

Third, make leadership and succession planning an explicit element of executive evaluation, especially for the CEO. Directors should make clear that CEO performance is not just measured by stock price and earnings growth, but requires performance in key leadership areas, such as putting into place a detailed, robust succession plan. That kind of “soft” performance issue too often gets cursory consideration in pay decisions. But when directors contemplate the consequences of a disorderly succession, the compensation implications become easier to take seriously. As for other executives, emphasizing the importance of their own succession signals the prospect of other new roles, such as lateral assignments, that enhance their executive experience.

Thoughtful and proactive executive compensation policies are important to CEO succession. Directors should strive to ensure balance in CEO/NEO compensation and be vigilant in ensuring that all its top executive talent is fully recognized for their ongoing contributions to the company’s success with long-term, extended vesting compensation. Finally, directors should make leadership and succession planning a high priority, with meaningful compensation implications, especially for the CEO. Ultimately, a strong succession-planning process helps prepare the entire organization to handle high-level departures when they inevitably occur.



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