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Passing the Torch: The Urgency of CEO Succession Planning

By Angela Moe and Brian Bueno

CEO DEPARTURES OCCURRING AT RECORD-HIGH LEVELS raise the stakes for boards to get succession planning right. In the United States, 622 CEOs announced their departures in the first quarter of 2024, representing a 48 percent increase from the first quarter of 2023 and the highest number of single-quarter departures ever, according to Challenger, Gray & Christmas's *CEO Turnover Report*.

The reasons for the increased departures are varied. Still, economic uncertainty, the pace of technological advancements, and shareholders' rising performance expectations are likely contributing to the current level of CEO churn. Some argue that the current election year also contributes to an environment where transitions may seem well-timed as markets prepare for a potentially different regulatory regime. Identifying, developing, and engaging the next generation of leaders in this increasingly complicated environment is critical to ensuring organizational success through leadership transitions.

Poorly orchestrated leadership transitions can sap a company's reputation and share price and negatively affect an organization. Unplanned or poorly executed CEO departures can create a leadership void and adversely impact an organization's culture. Such business disruptions can leave employees without guidance, stability, or vision. A poorly managed transition can also cause other top leaders to depart, worsening the problem.

The correlation between poorly managed CEO transitions and market value was the subject of the *Harvard Business Review*'s "The High Cost of Poor Succession Planning" that reported, "The amount of market value wiped out by badly managed CEO and C-suite transitions in the S&P 1500 is close to $1 trillion a year." Better succession planning, the authors projected, could result in higher company valuations and investor returns.

While most boards manage CEO succession well, examples of poor transitions abound. In recent years, shareholders have communicated explicit expectations around succession planning. BlackRock's 2024 *Investment Stewardship: Proxy Voting Guidelines for US Securities,* for instance, expects companies to have a robust CEO and senior management succession plan in place at the board level that is regularly reviewed and updated, "covering scenarios over both the long-term, consistent with the strategic direction of the company and identified leadership needs over time, as well as the short-term, in the event of an unanticipated executive departure." In cases of significant concerns regarding a board's succession planning efforts, BlackRock may vote against members of the responsible committee or the most relevant director.

For companies evaluating if or when their CEO or other executives may be looking for the exit sign, age can be a useful barometer to predict a transition and a meaningful reminder for boards to plan for CEO succession before it is too late. Currently, about 18 percent of S&P 1500 CEOs are over the age of 65, and 6 percent are over the age of 70, according to a Farient analysis. At companies with leaders of an older age, shareholders are especially interested in ensuring the company has a succession plan in place, a pipeline of CEO candidates ready to take the helm after a planned exit, and contingency plans for any emergency or unexpected departures.

Farient reviewed succession planning disclosure among S&P 500 companies with CEOs 70 years or older. Among the companies reviewed, almost all companies (89%) disclosed the direct involvement of the board in succession planning, but specific details were often scant and varied by company. Key findings include:

- A minority of companies (39%) give succession planning prominence in their proxy disclosure by having it as a standalone section or discussion.
- Half of companies disclose the delegation of succession planning to a particular board committee, typically the compensation or nominating and governance committees.
- Twenty-eight percent of companies disclose having identified a pipeline of candidates for the CEO role.
- Only 22 percent of companies discussed an evaluation of skill sets or experience among CEO pipeline candidates.
- Only 39 percent disclose having a contingency plan in the event of an unexpected CEO departure.

The best succession planning disclosures exhibited a thoughtful discussion around process, involved parties, evaluation criteria, and contingency plans. This can give investors confidence that the company's board maintains a thorough and considered process for identifying and developing successors for the CEO. Best practices for CEO succession planning disclosure include:

- CEO succession as a standalone section or discussion in the proxy statement,
- CEO and other management (e.g., the chief human resources officer) involvement in the succession planning process,
- a minimum annual review of CEO succession planning,

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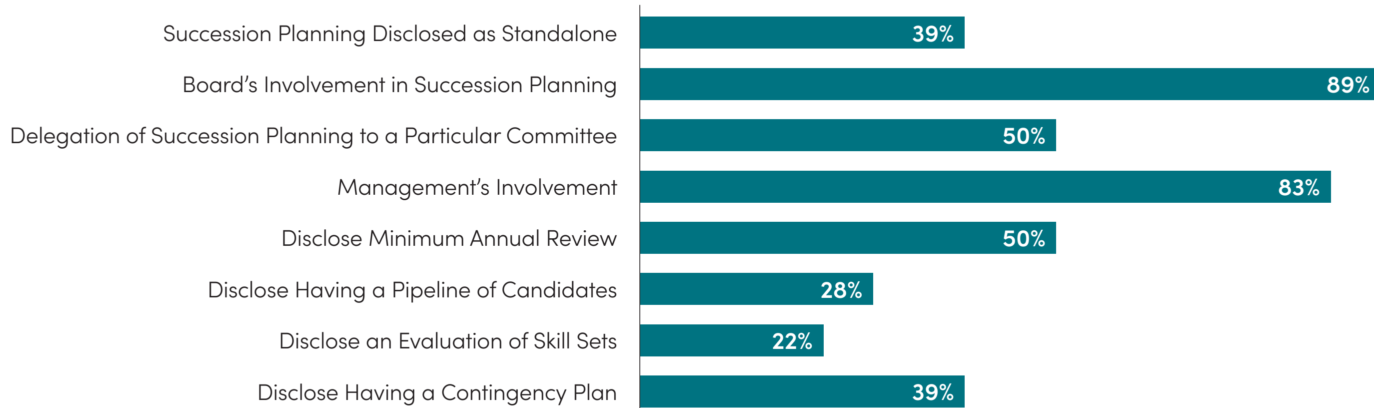


- disclosure of a pipeline or identification of potential CEO candidates,
- disclosure of an evaluation of skill sets, experience, or "readiness" for developing identified candidates,
- disclosure of succession planning for top executives in addition to the CEO, and
- disclosure of a contingency plan or candidate in the case of an emergency CEO transition.

Broadcom is one example of a company with exemplary succession planning disclosure, exhibiting most or all the abovementioned characteristics and demonstrating active involvement in managing succession for its CEO and senior management. In its 2024 proxy statement, Broadcom notes that the board discusses this topic "at least biannually." It highlights a contingency plan that would utilize internal candidates if its CEO cannot perform their duties. Additionally, Broadcom's board, CEO, and vice president of human resources regularly discuss senior management succession planning. The board reviews the qualifications and experience of potential successors and the development priorities and achievements of those successors; it also engages with the potential internal successors "at least annually at board meetings and in less formal settings."

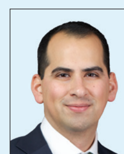
Some S&P 500 companies with CEOs aged 70 or older disclose very few details of their succession planning efforts. Minimal disclosure may show a lack of a defined process, indicate poor governance, or reflect the company's ownership structure. Regardless, more robust disclosure could help ease shareholder concerns or, at a minimum, assure that a process is in place to avoid significant disruptions in the case of a CEO departure, planned or otherwise. There are many benefits to strong succession planning, and the costs of poor planning are immense. As such, shareholders have an understandable expectation of knowing how a company manages this sometimes-tricky process.

CEO succession should be any board's top governance priority. An interim successor must be known if an unexpected incident were to occur.

Critical considerations for board directors include:

- Ensuring CEO succession planning is an ongoing process, reviewed by the board at least once per year.
- Supporting collaboration with the CEO, internal candidates, and the chief human resources officer.
- Recognizing that the development of high-potential internal candidates for the top job takes years to expose them to more expansive and challenging opportunities, disciplines, customers, and markets.
- Considering external candidates who may be recruited and cultivated into leadership roles in addition to internal candidates.
- Considering how to tie investments to retention and development, i.e., how much to spend and where to place bets.
- Defining your company's process and disclosing it for the benefit of shareholders.
- Adding a short, standalone section in the proxy statement around talent and executive succession planning that covers various aspects, such as:
  - the board's or individual committees' role,
  - the CEO's and other top management's role (e.g., the chief human resources officer),
  - whether the board has a pipeline of potential candidates, and
  - whether and how the company works to develop identified candidates.
- Including succession planning discussions as part of shareholder engagement efforts.

Ultimately, every CEO needs to make way for a new successor, and poor CEO transitions can happen at any company. A strong and well-defined succession plan where the board and CEO take an active role and shareholders are engaged provides a strong governance foundation for future leadership transitions. D



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