15th annual CEO succession study

The value of getting CEO succession right
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 by -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 AU$2.0 billion in foregone shareholder value.
This year’s study of CEO’s succession paints a varied picture for the boards, CEOs and shareholders of leading Australian companies. Some areas of strength are evident, whilst a number of areas for improvement have surfaced.

Leading Australian companies saw 42 CEO turnovers in 2014 – almost 35 percent more CEO turnover events relative to leading global enterprises. Whilst Australian companies have shown an improvement in the ability to plan succession for the top job against the long run Australian average, Australian boards are still being forced into CEO-separation more than global boards.

Forced CEO turnover events led to significantly greater loss in shareholder value in Australia – estimated around AU$8bn – relative to shareholder outcomes from global companies, suggesting a pressing need for Australian boards to institutionalise the CEO succession planning process and take active steps to increasing CEO tenure.

The incoming class of CEOs in top Australian companies was amongst the youngest globally, with a median age of 51. They were also represented by the most regionally diverse set of leaders, more consistently engaged from outside of Australia, than leaders appointed into top global firms. The incoming class also consisted of the greatest proportion of females globally. This continues the trend we observed in last year's study of a slowly increasing share of women CEOs in Australia which remains at minuscule levels but shows encouraging signs of improvement.

We also observed more CEO stability in leading Australian companies than the long run average tenure. The term in office increased to 5 years.
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 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 AU$67.5 billion in shareholder value annually (assuming all else stays the same).

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

In addition, we see clear correlations between companies with planned turnovers, companies in the top quartile of performance2 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 highest – performing companies have hired 79 percent of their CEOs from the inside compared with 70 percent at the low performers.
High performers 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 turnover 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.

In 2014 leading Australian companies experienced relatively more CEO turnover events than their global counterparts – 21 percent compared to 14 percent globally – equating to 35 turnover events (excluding M&A activities).

Of the turnover events, Australian companies also demonstrated a less planned approach than their global counterparts, with 77 percent planned turnovers in Australia versus 86 percent globally. Whilst leading Australian companies have improved their ability to plan CEO succession (the long run average is 72 percent) more unplanned events occurred in 2014 than the previous two years – suggesting a slight dip in focus on succession planning for the top job.
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 stabilise sooner after any kind of turnover.

Gary L. Neilson

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 annualised relative total shareholder returns (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 of 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 of companies with only one turnover.

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
AU$126 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 TSR in the year leading up to a CEO turnover as well as the year after it. In the preceding year, median total shareholder returns (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 AU$126 billion a year— that’s roughly AU$2.0 billion for each company more than if their turnovers had been planned.

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 AU$67.5 billion in value (all else staying the same).

Relative to their top global counterparts, leading Australian company turnover events resulted in significantly greater loss in shareholder value in the year leading up to a CEO turnover (-5.5 percent), as well as the year after it (-11.4 percent), or between twice to three times the erosion in shareholder value compared to top global firms, equating to AU$8bn foregone. This suggests that there is an even greater need in Australia than globally for boards to institutionalise the process of planning for succession, and taking formal steps to increase CEO tenure.

Australia and global
Australian & Global companies losses resulting from CEO turnover

Source: Strategy& analysis

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

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.

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.

In 2014 the incoming class of CEOs in Australia shared a set of unique characteristics, compared to their global cohort of incoming top leaders. Firstly, whilst they were not the youngest, they were younger than the global average and the existing ASX 200 average – with a median age of 51, compared to 52 globally, and 56 across the ASX 200.

Australia
Incoming CEO median age by company headquarters region 2014

Source: Strategy& analysis

1) “Other mature” economies include Argentina, Australia, Bahrain, Chile, Cyprus, Czech Republic, Hong Kong, Hungary, New Zealand, Poland, South Korea, etc.

2) “Other emerging” economies include Egypt, Kazakhstan, Mauritius, Mexico, Mongolia, Nigeria, South Africa, Turkey, etc.

Note 1: “Mature” countries are defined as per the U.N. Development Programme 2013 ranking of countries with “very high human development” (human development index >0.80); all others are “emerging” countries.

Note 2: Exhibit excludes turnover events resulting from M&A, interims, and events with incomplete turnover information.
Secondly, they were represented by one of the most diverse set of leaders with 5 incoming CEOs from regions outside of Australia and New Zealand.

**Australia**

**Incoming CEO nationality compared with company headquarters region 2014**

<table>
<thead>
<tr>
<th>Region</th>
<th>Global</th>
<th>ANZ</th>
<th>U.S., Canada</th>
<th>Western Europe</th>
<th>Japan</th>
<th>Other emerging</th>
<th>China</th>
<th>Brazil, Russia, India</th>
<th>Other emerging</th>
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<td>2%</td>
<td>0%</td>
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<tr>
<td>Different country, different region</td>
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<td>2%</td>
<td>100%</td>
<td>83%</td>
<td>78%</td>
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</tbody>
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Source: Strategy& analysis

1) “Other mature” economies include Argentina, Australia, Bahrain, Chile, Cyprus, Czech Republic, Hong Kong, Hungary, New Zealand, Poland, South Korea, etc.

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Note 2: Exhibit excludes turnover events resulting from M&A, interims, and events with incomplete turnover information.

Thirdly, relatively, they were represented by the greatest proportion of incoming females globally – with 3 female CEOs joining leading companies – almost 60 percent greater than the 2014 global average. This continues the trend we observed in last year’s study of a slowly increasing share of women CEOs in Australia; however the number of female CEOs remains at a very low level compared with their male counterparts in the top job.

**Australia**

**Share of incoming women CEOs 2010-2014**

Source: Strategy& analysis
Based on our analysis in Australia since 2007, the number of female outside hires is 70 percent greater than males for the CEO role. However, over the same period, the number of female CEOs forced out of their job was 40 percent greater than their male counterparts.

Female CEOs are more often forced out of office than male CEOs

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<th>Forced</th>
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<tr>
<td>Female</td>
<td>37%</td>
<td>63%</td>
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<tr>
<td>Male</td>
<td>27%</td>
<td>73%</td>
</tr>
</tbody>
</table>

Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A and interims for incoming CEOs and events with incomplete turnover information for incoming or outgoing CEOs.

Regional and Industry Trends in CEO Turnovers

After several years of lower than median CEO tenure, the average term in office for an Australian CEO increased in 2014, to 5 years – about 10 percent more than the long run average, but still slightly below the expected tenure of a global CEO, highlighting room for further improvement in Australia.

Australia
Outgoing CEO Median Tenure (Years in Office) 2006-2014

Source: Strategy& analysis

Note: Exhibit excludes turnover events resulting from M&A and interims for incoming CEOs and events with incomplete turnover information for incoming or outgoing CEOs.
Conclusion

Our findings demonstrate the critical importance of proactive board-level involvement in CEO succession planning. The most recent CEO succession results for leading Australian companies highlight the erosion in shareholder value arising from CEO succession. By institutionalising the CEO succession process, boards will help to reduce unplanned succession and increase CEO tenure.

During 2014 leading Australian companies have demonstrated the ability to attract a talented and differentiated incoming class of CEO. Australia’s newest top leaders come from more geographically diverse origins than other leading global firms, are amongst the youngest, and relatively include more female members than their global counterparts.

Looking ahead, we recommend that leading Australian boards prioritise the establishment and institutionalisation of a formal CEO succession process, coupled with a heightened focus on internal high-potential talent management, and talent development. Reducing the level of female turnover, and increasing the level of planned, internal succession will help Australian boards to increase CEO tenure and reduce erosion of shareholder value, whilst also creating internal progression pathways for high performers into the top leadership job.
Methodology

Global
This study of CEOs, Governance, and Success identified the world’s 2,500 largest public companies, defined by their market capitalisation (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 annualised.

Australian
The Australian specific component of the global study identified all companies listed in the ASX 200 since 2000, a data set spanning 341 companies. We used annual reports and press searches to learn if and when a CEO turnover event had taken place for all these companies since 2000, identifying every company’s CEO for each fiscal year, confirming the turnover event, and determining the reason. Factiva helped us identify announcements of retirements or new appointments of CEOs, as well as presidents and managing directors, for the ASX 200 companies. Total shareholder return data for a CEO’s tenure was sourced from Bloomberg and includes reinvestment of dividends (if any).

Each company that experienced a CEO change was analysed to confirm the change had occurred, the name of the outgoing executive, and the true reason for the turnover event. Consistent with the global study, three reasons were identified for a CEO transition event in Australia: Regular transitions, which included planned retirements, the CEO’s acceptance of a position elsewhere, health-related departures, or death in office; Merger-based transitions, in which a CEO’s job was eliminated after an acquisition; and Forced transitions, which included any departure initiated by the board, attributed by the media to poor financial or managerial performance, or where the company was clearly underperforming but the departure was described as being for “personal reasons”.

For certain data points in the Australian study, data from 2009 to 2014 was used rather than the 2014 data used in the global study. This was done to account for the small sample size in Australian CEO succession data, compared with the much larger global dataset.

All financial data are expressed in Australian dollars as at 01 January 2014. Gender and age based data for ASX 200 companies in 2014 is based on analysis of CEO data from CONNECT4 BoardRoom.


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Notes

1. The 2014 breakdown by type of turnover including M&A is 78 percent planned, 13 percent forced, and 9 percent M&A.

2. We state all total shareholder return figures as annualised TSR over outgoing CEOs’ total tenure and we regionally adjust the figures, meaning that performance is measured relative to a regional index (For example: S&P 500, Brazil Bovespa, FTSE 100 and CAC 40).

3. This analysis is based on turnovers occurring in 2011, 2012, and 2013 for which full turnover and market capitalisation information is available.
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