

# Communicating Critical Events: CEO Transitions and Risk to Enterprise Value

FTI Consulting | Strategic Communications Practice

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# Global leadership transitions

## Research objective & methodology

### Objective

- To explore the value-at-risk (VAR) associated with leadership changes, segmented based on the circumstances leading to the CEO transition.

### Primary Research

- FTI Consulting conducted primary research among institutional investors. In total , FTI Consulting solicited feedback from **358** portfolio managers and analysts across **37** countries. At 95% confidence margin of error is +/- 5.17%.

### Secondary Research

- FTI Consulting Global CEO Transition Study considered all CEO transitions among companies that had a market capitalization greater than \$10B at any point during the time period of July 1, 2007 through June 30, 2010 – This resulted in **263** CEO transitions across **35** countries.
- To determine the value-at-risk, the selected CEO transitions were analyzed based on net stock price performance relative to a comparable index commonly referred to as “**alpha**” (i.e., a positive alpha indicates the stock outperformed its benchmark index).

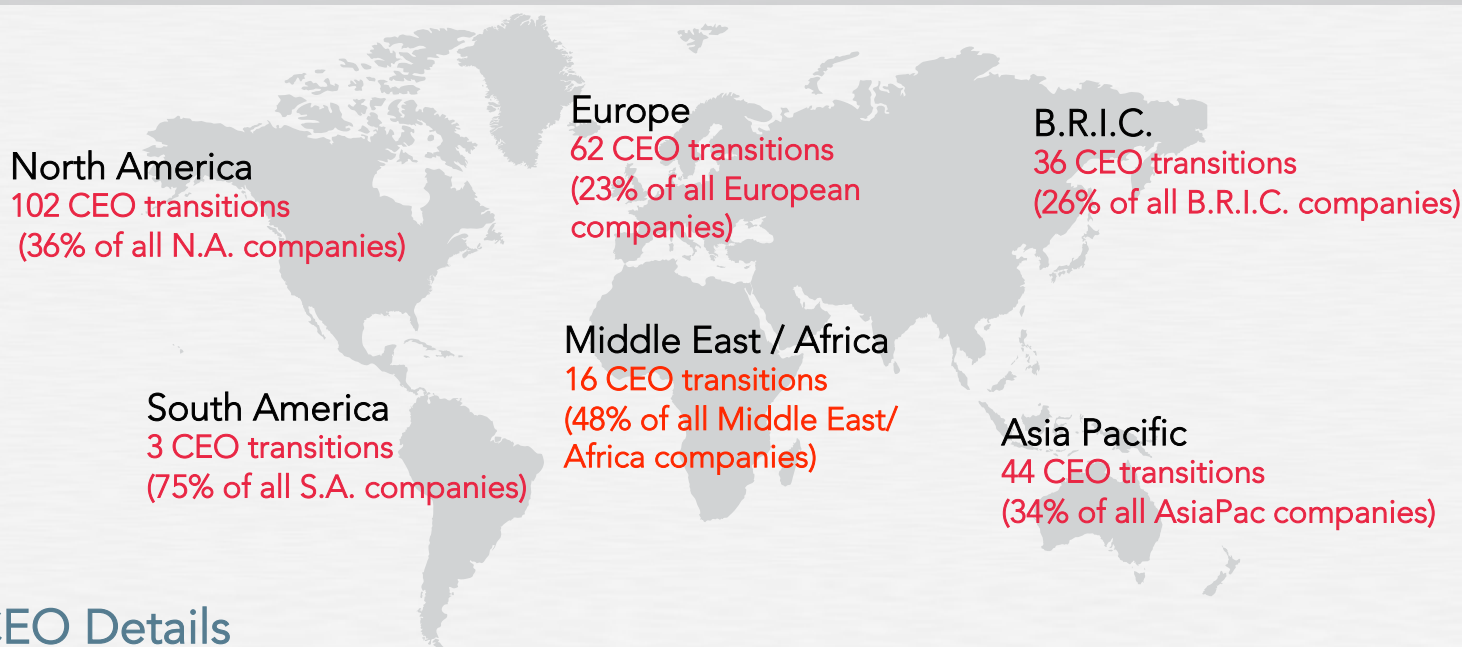
# Profile of the Sample Population

## Global CEO Transition Study

# Significant turnover of large-cap company CEOs

## CEO Transitions

**31%** of companies announced a CEO transition\* **of those** **43%** were unplanned, or not part of a succession plan



## New CEO Details

**80%** had no prior CEO experience **and** **77%** came from within the company

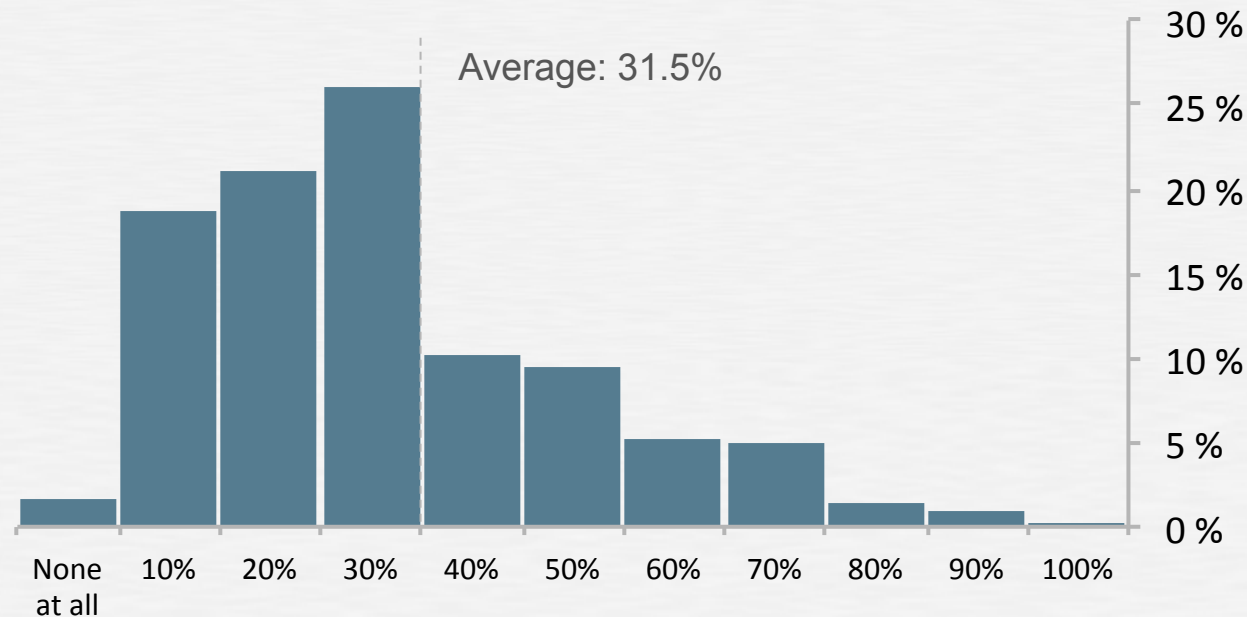
# Importance of CEO reputation and its influence on investment decisions

## Global CEO Transition Study

# CEO reputation equals one-third of investment decision

- The perception of the CEO influences almost one-third of the investment decision

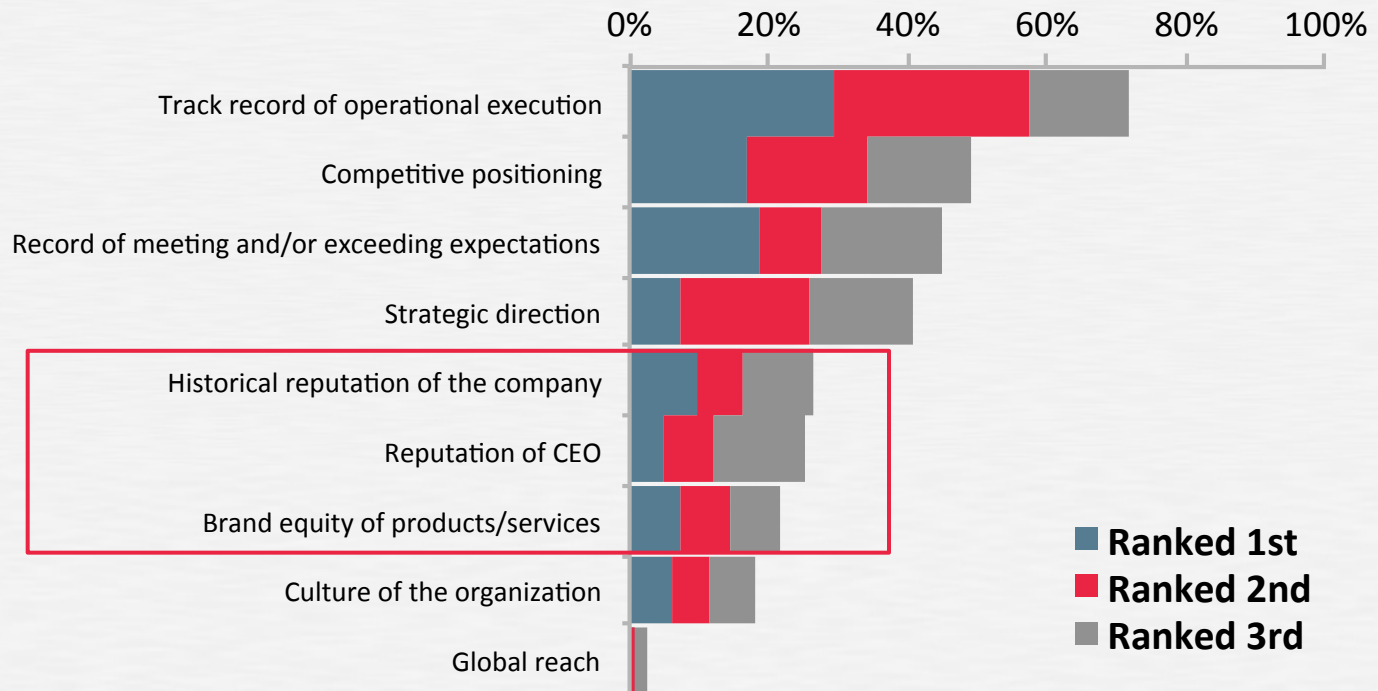
## % of investment decision based on perception of CEO



# CEO reputation as important as reputation of company

- The reputation of the CEO is nearly as important as the reputation of the company, and more important than the reputation of the company's products or services

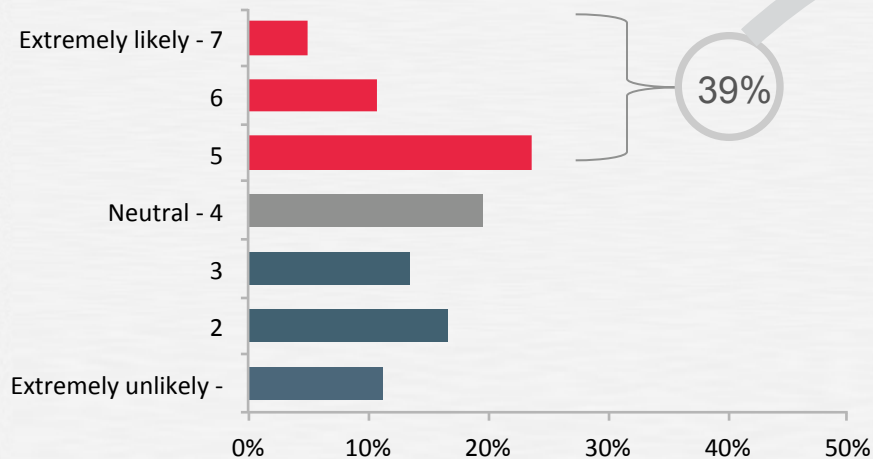
## Key factors impacting an organization's reputation



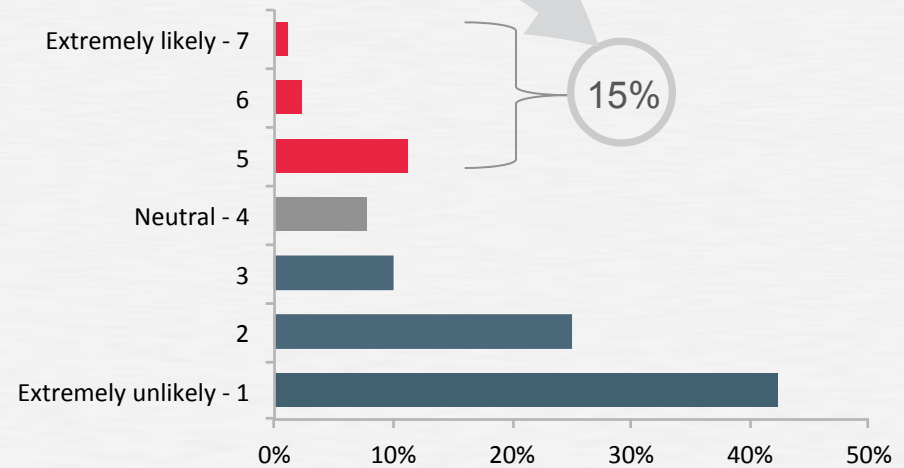
# CEO transitions offer more risk than opportunity

- There is more risk to the CEO appointment than opportunity
- The propensity to sell shares because of the CEO is more than twice that to buy shares

## Decision to sell stock



## Decision to buy stock



**Question(s):** Under exceptional circumstances, how important is the CEO to your investment decisions making process?  
How likely would you be to buy a stock based solely on the CEO, when no other investment criteria are met? and How likely would you be to sell a stock based solely on the CEO, when all other investment criteria are met?

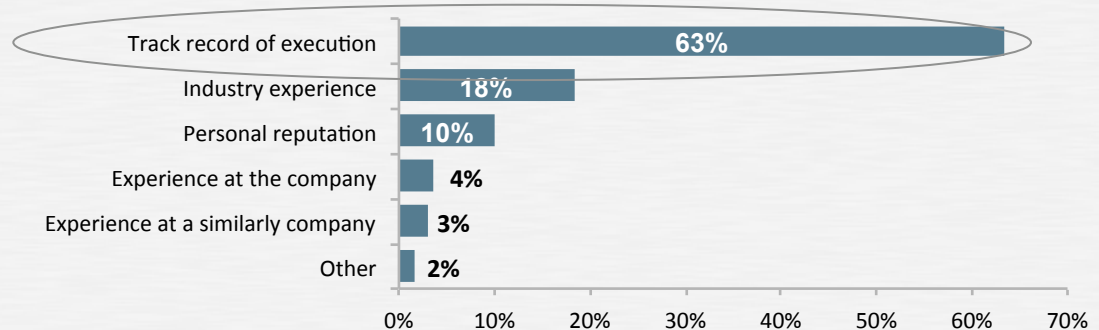
# Investor assessment of a new CEO

## Global CEO Transition Study

# Investors first look to prior track record and former business associates to assess an incoming CEO

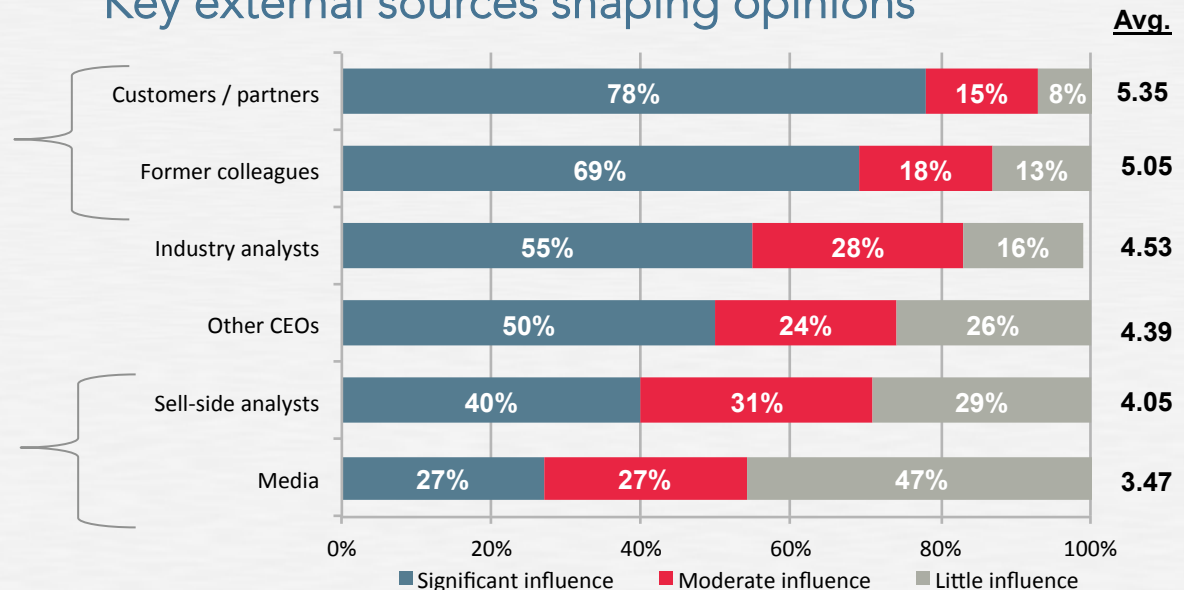
- The prior track record follows the executive to his/her new company and is far and away the most important factor for investors' assessment of the new CEO

## Key factors shaping initial opinions



- The most influential stakeholders are those with whom the CEO did/does business with
- Industry and sell side analysts are also influential
- The media have the least influence on shaping public opinions

## Key external sources shaping opinions



**Question(s):** Prior to meeting a new CEO, which factor is most important to you in forming your initial opinion of him/her? To what extent do the following external sources influence your opinion of a newly appointed CEO? (Please rate the following on a scale of 1 to 7, where 1=No influence, 4=Moderate influence, and 7=Significant influence)

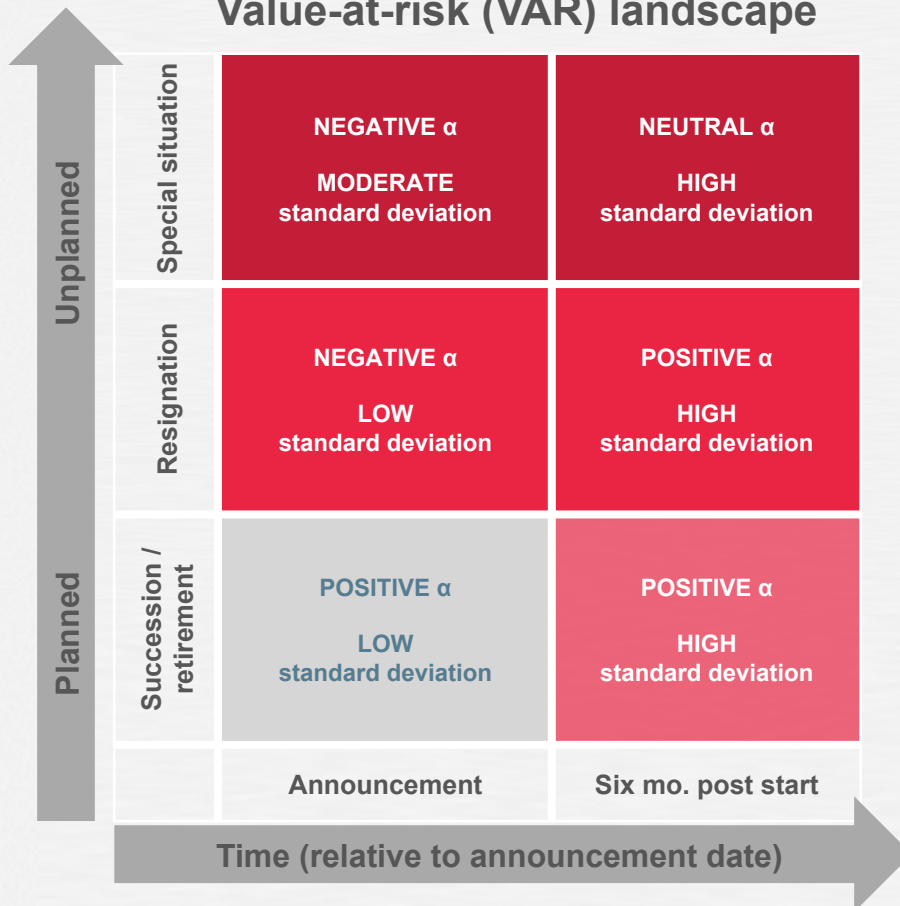
# Value-at-Risk in CEO transitions

## Global CEO Transition Study

# Enterprise value at risk increases as time passes

The greater the element of surprise and the higher the potential risk of corporate strategy shifts, the more enterprise value at risk

## Value-at-risk (VAR) landscape



- **Special situations**, such as strategic transformations, bankruptcies/restructurings and fraud/investigations, presented the most value at-risk (VAR) of all transition types, over both time periods considered

- Both **voluntary and forced resignations** demonstrated significant VAR

- **Succession / retirement** situations resulted in limited VAR upon announcement

- **VAR increases over time for all transition types:** more value is created /destroyed post-announcement, and depends on the actions and success of the new CEO

VAR: Value-at-risk

NEGATIVE/NEUTRAL/POSITIVE  $\alpha$ : average performance net of comparable indices for the circumstances and time period specified

LOW/MODERATE/HIGH standard deviation: standard deviation of  $\alpha$  for the circumstances and time period specified

# VAR by situation

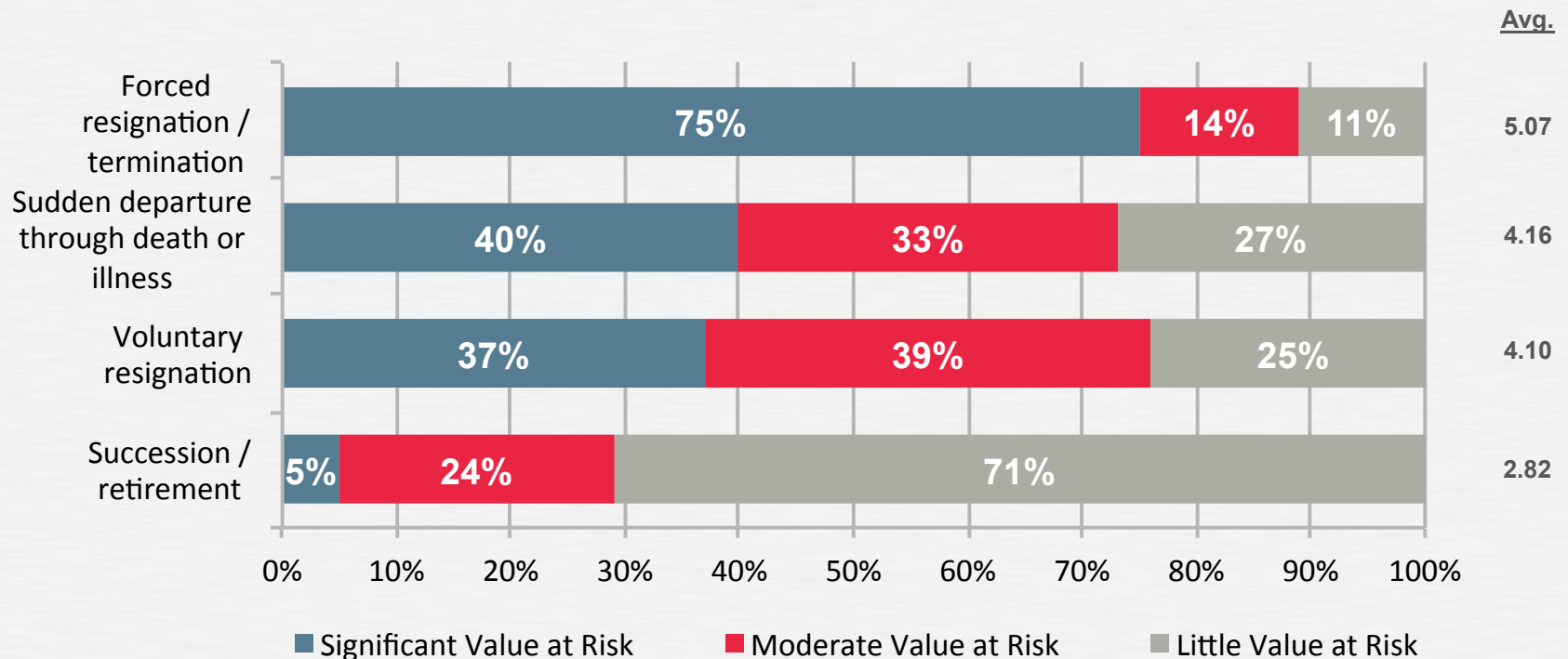


- Strategic transformation:** VAR correlated to broader corporate change. Strategic transformations had highest negative alpha across all intervals, and 2<sup>nd</sup> highest potential VAR with unsuccessful transitions garnering an average \$24B market cap erosion (-17% average alpha) six months post CEO start.

- Company circumstances more impact on VAR than how CEO departs:** Company-specific factors, such as fraud, regulatory investigations strategic transformations and restructuring/ bankruptcy, have more impact on VAR than how the CEO departed (e.g., resignation vs. succession)

# Investor perceptions of risk also related to degree of 'surprise' and corporate change

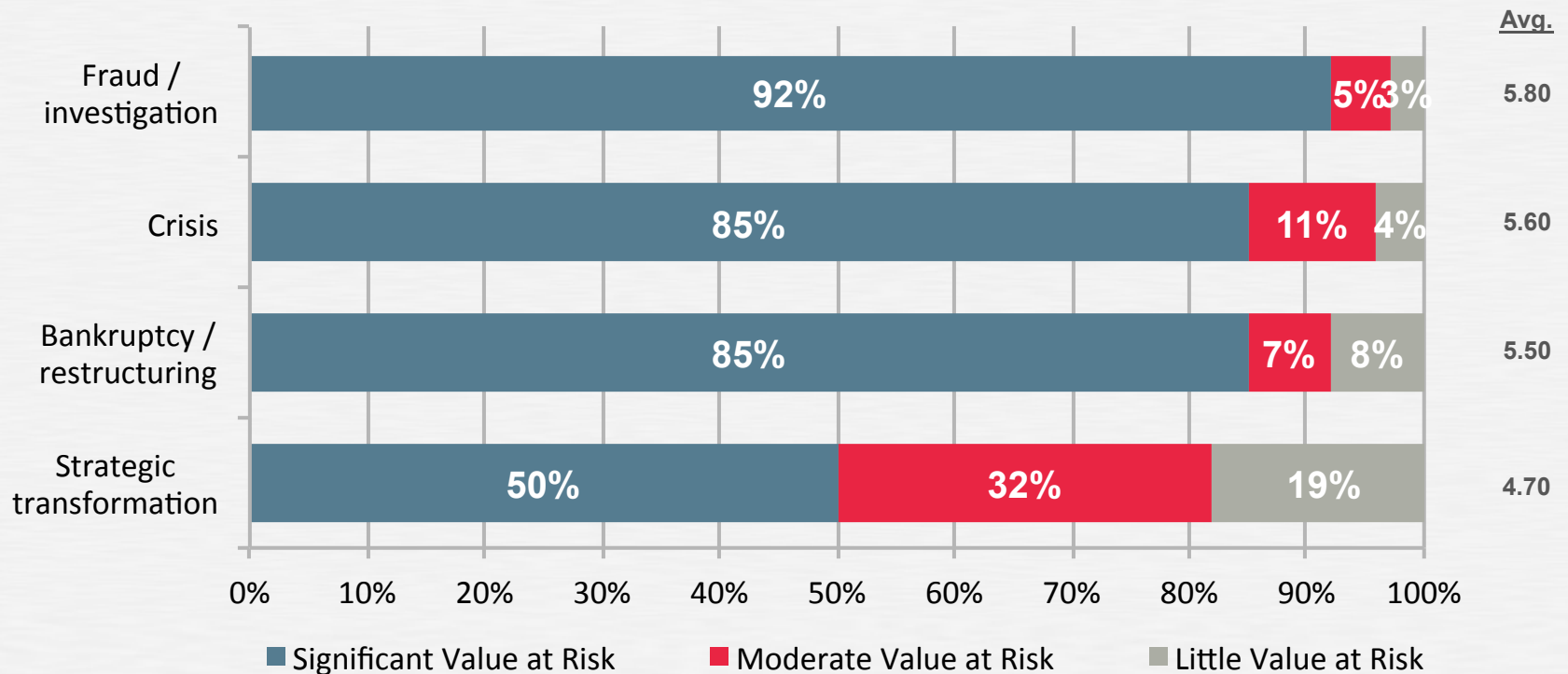
## Value at-risk due to outgoing CEO circumstances



- Abrupt changes impact short-term enterprise value the most

# Investor perceptions of risk also related to degree of 'surprise' and corporate change

## Value at-risk due to Company circumstances



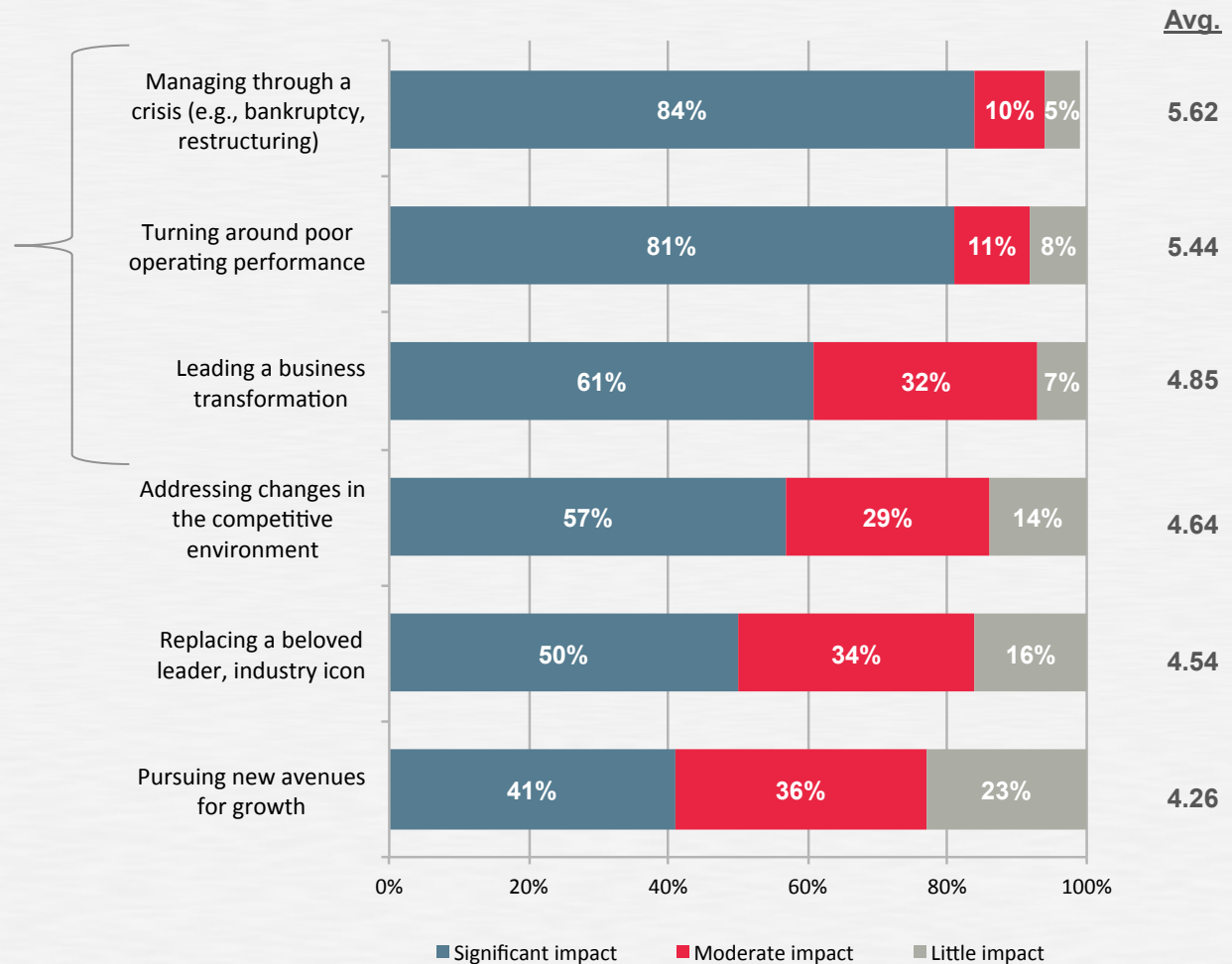
- Significant enterprise threats and transformations impact long-term enterprise value the most

**Question:** Under the following CEO transition circumstances, how much market capitalization do you believe is at risk?  
(Please rate the following on a scale of 1 to 7, where 1=No value at risk, 4=Moderate value at risk, and 7=All value at risk)

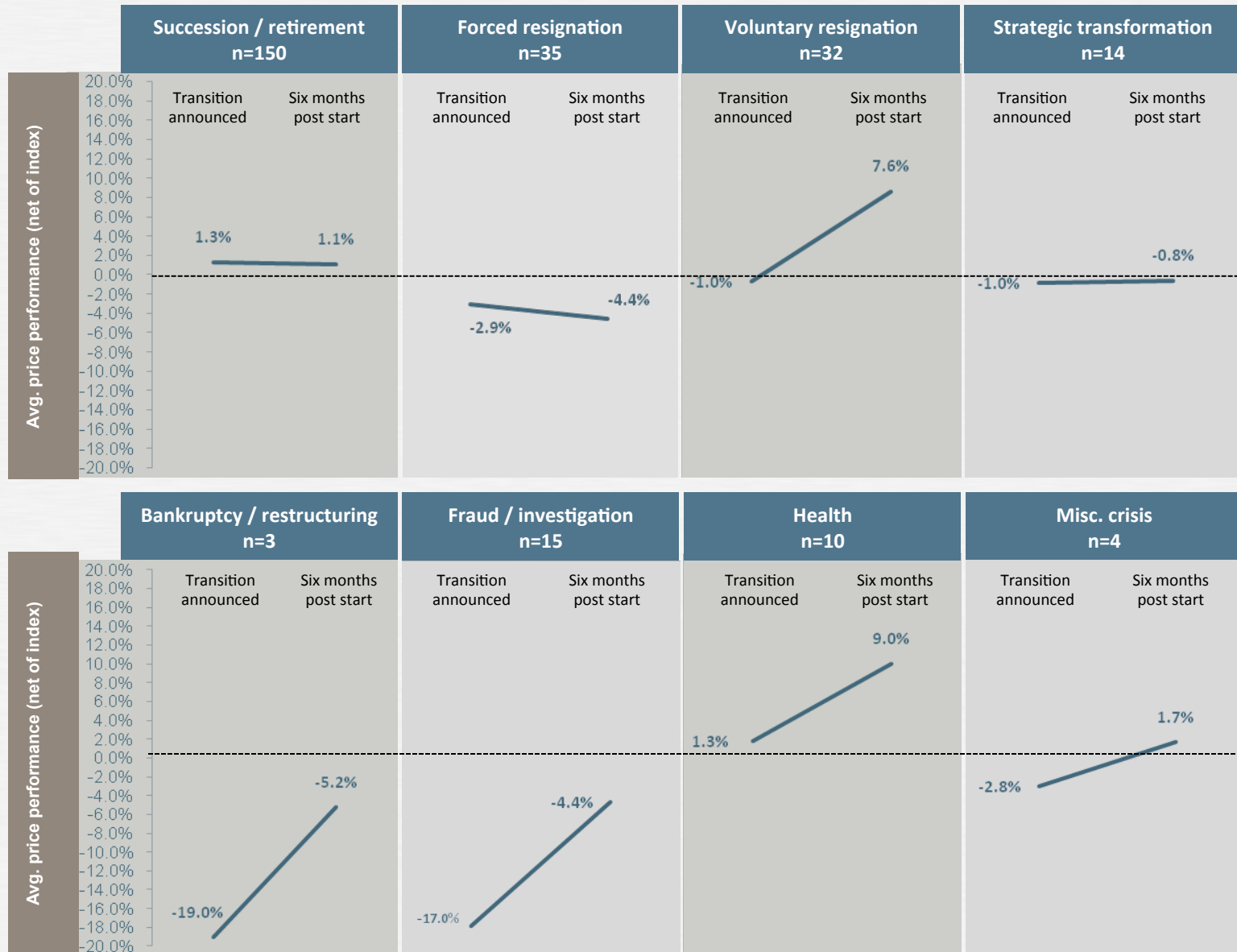
# VAR is proportionate to situational urgency, but all instances present risk

## Key factors

- The more challenging the situation, the greater the threat to the enterprise, the more value is hanging on the outcome



# Management initiatives can reverse initial negative actions, in most cases



# Roadmap for a new CEO

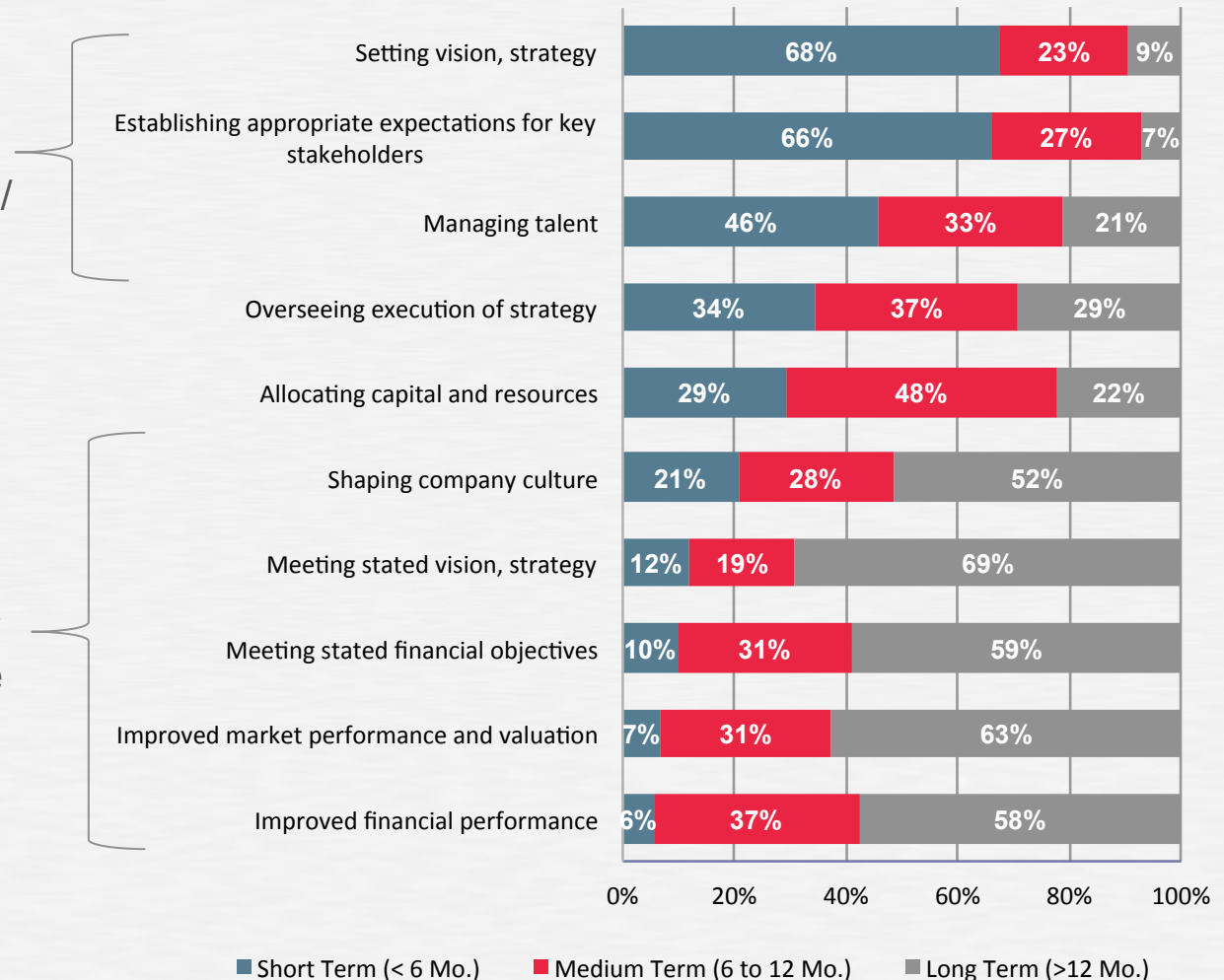
## Global CEO Transition Study

# There is a honeymoon period for new CEOs in the first six months to set vision, strategy and expectations

## Key functions and actions of a new CEO

- Investors expect the new CEO to assess the situation, create the vision/strategy and set expectations

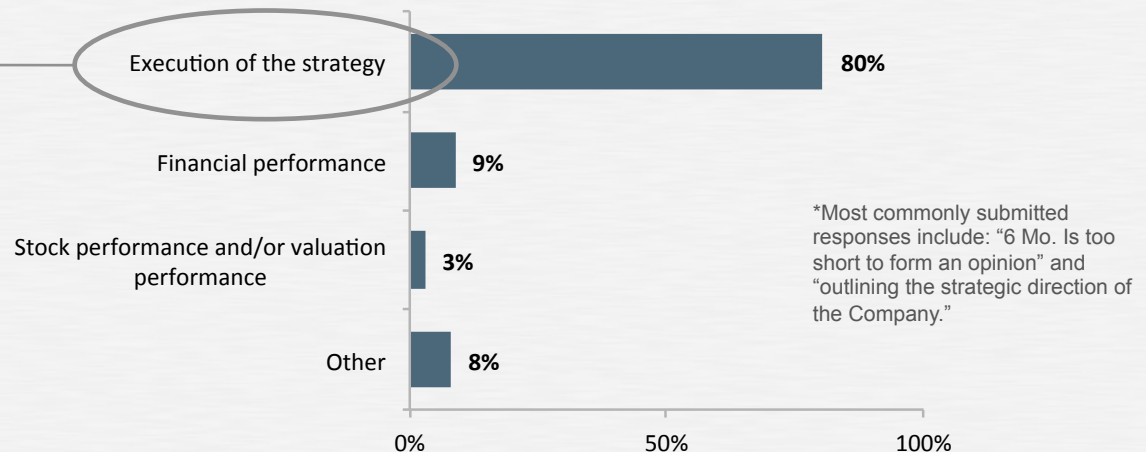
- Expectations for performance are relatively long term (mostly after the first year)



# New CEO's effectiveness is measured by strategy execution and financial stewardship

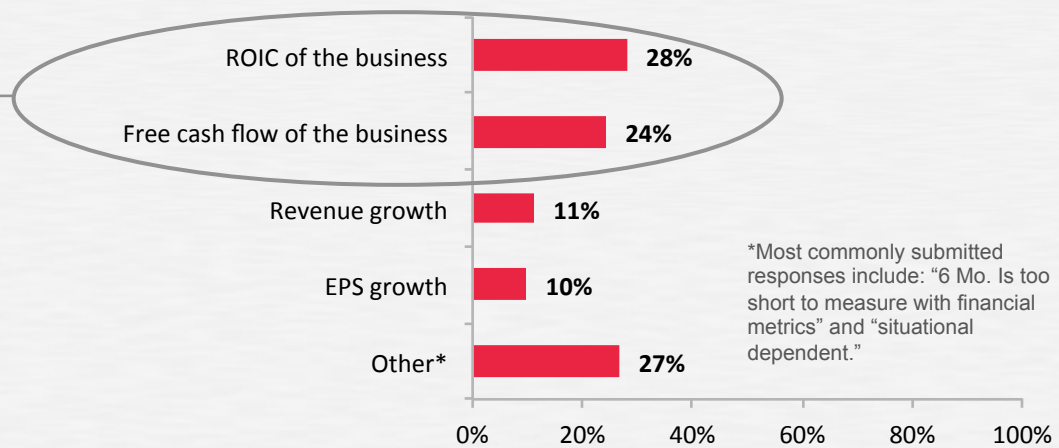
## Most important measures of effectiveness

- CEO will be held to his/her strategy



## Most important financial metrics

- Stewardship of the Company's capital and assets is the most important financial measure of success

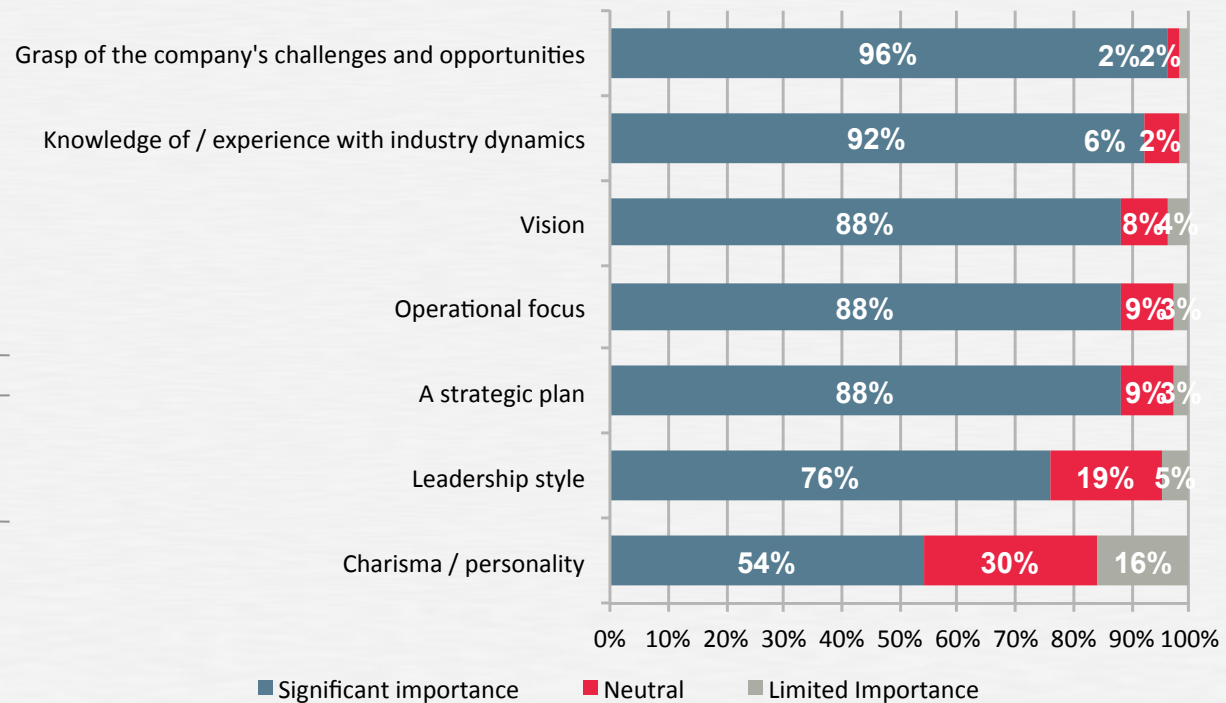


**Question(s):** Within the first six months following a leadership change, which of the following is most important when measuring the effectiveness of a new CEO? Within the first six months following a leadership change, which financial performance metric is most important to measuring the effectiveness of a new CEO?

# Investors take a multi-dimensional view of a new CEO

## Key factors during initial interactions with new CEO

- Investors primarily look to see how the incoming CEO plans to take command of the company
- A substantive grasp of the Company's situation and plans for the future are very important
- Vision and leadership style are also important in initial interactions



# Research overview & methodology

# Global leadership transitions

## Research objective

The objective of our research was to explore the value-at-risk (VAR) associated with leadership changes, segmented based on the circumstances leading to the CEO transition.

The FTI Consulting Global CEO Transition Study considered all CEO transitions among companies that had a market capitalization greater than \$10B at any point during the time period of July 1, 2007 through June 30, 2010 – This resulted in 263 CEO transitions across 35 countries.

The CEO transitions were grouped and further analyzed by the following categories based on the circumstances leading to the transition:

- **Succession / retirement** – orderly, planned CEO transitions that resulted from retirement scenarios;
- **Resignation** – including:
  - Voluntary resignation – situations in which the departing CEO left to pursue other opportunities; and,
  - Forced resignation – situations where there was evidence of a termination or forced removal from office.
- **Special situations** – including:
  - Strategic transformation – significant change in strategy or market position;
  - Bankruptcy / restructuring – bankruptcies or significant restructuring ;
  - Fraud / investigation – corporate scandal/wrongdoing or federal investigation;
  - Health – death or other serious illness that results in a CEO departure; and,
  - Miscellaneous crisis – other event-driven/unforeseen circumstance (e.g., natural disasters.)

# Methodology

## Secondary research

To determine the value-at-risk, the selected CEO transitions were analyzed based on net stock price performance relative to a comparable index commonly referred to as “alpha” (i.e., a positive alpha indicates the stock outperformed its benchmark index).

- Stock performance was benchmarked against relevant comparable indices based on the country of domicile and local exchange (e.g., S&P 500, FTSE 100 Index, Nikkei 225 Index, Germany DAX Index, Paris CAC 40 Index).

Net stock price performance (alpha) was measured on two intervals:

- **Transition Announced** (initial announcement of CEO departure) – measures the initial market reaction (one week prior to day of announcement) of the CEO change; one week was used to account for potential news leakage, global market time zones, etc.; and,
- **Six-Months Post Start** (succeeding CEO starts) – measures the stock performance six months following the start date of the incoming CEO.

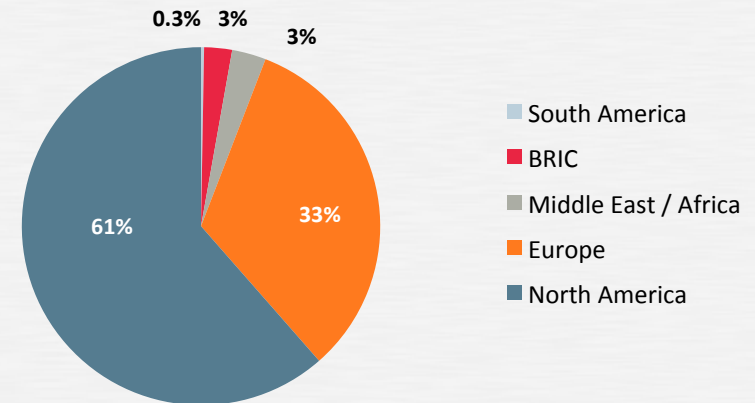
Each transition was further classified based on a number of characteristics to fully encapsulate the details of the situation including background of the incoming CEO and circumstances that lead to the transition.

# Methodology

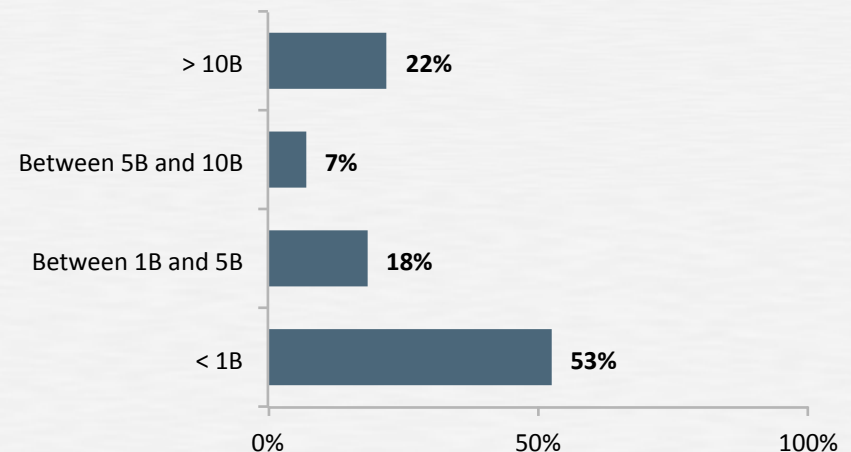
## Primary research – global investor survey

- To further explore the value-at-risk associated with a CEO transition, FTI Consulting conducted primary research among institutional investors.
- Using an online survey format, FTI Consulting solicited feedback from the investment community to better understand the extent to which CEO reputation in general, and leadership changes in particular impact investment decisions and therefore enterprise value.
- The research was conducted globally, covering a cross-section of countries represented by the sample set.
- In total, FTI Consulting solicited feedback from **358** portfolio managers and analysts across **37** countries. At 95% confidence margin of error is +/- 5.17%.

## Survey demographics – by region



## Survey demographics – by AuM



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