Booz | Allen | Hamilton

Business Council of Australia

# CEO Turnover in 2002

## Trends, Causes and Lessons Learned

# CEO Turnover in 2002

## Trends, Causes and Lessons Learned

### 1. Introduction

In May this year, a worldwide study by Booz Allen Hamilton found that forced CEO turnover is becoming the new norm. As shareholders and markets generally demand higher and higher performance from companies and senior management this phenomenon is now fully global.

The findings have significant implications not just for chief executives and senior management, but also company boards, shareholders and the market generally.

It speaks to issues such as the rising tide of shareholder activism, the heightened focus on corporate governance and increasing expectations upon chief executives to deliver more within shorter timeframes.

To test whether these global findings were also valid “down under”, Booz Allen has extended the global study to Australia as a joint initiative with the Business Council of Australia.

The purpose was to analyse CEO turnover for ASX 200 companies. In total 178 companies have been included in the study. Of the top ASX 200 companies twenty-two organisations experienced a CEO succession event in 2002.[1]

The study found that not only is the rate of CEO turnover higher than in Europe and North America, there is also significantly less time for Australian CEOs to execute their strategies and plans.

The study found that:

- CEO turnover rates for Australian CEOs are higher than overseas (Australia 16.8% versus 10.1% globally)
- Merger and acquisition (M&A) related CEO turnover in Australia is higher compared to the global average (Australia 21% of all turnover events versus 14% globally)
- Average tenure for CEOs leaving office, forced or otherwise, in Australia in 2002 was almost half the global average (4.4 years in Australia versus global average 8.6 years)
- CEOs departing for performance reasons delivered significantly poorer second-half returns than their global counterparts
- Consistent with the global study, financial services is the safest sector for CEOs in Australia

[1] *For a more detailed understanding of the methodology, please refer to the methodology section at the end of the viewpoint*

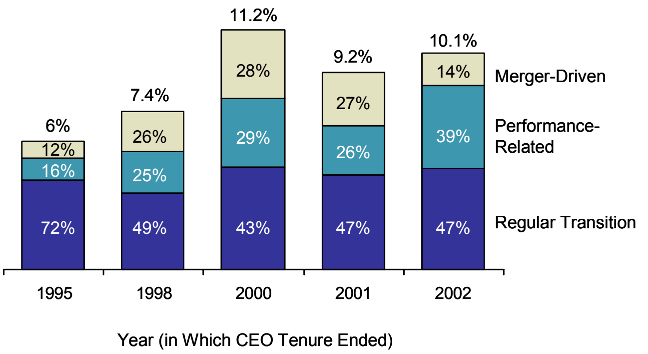
## 2. The Global Context

Internationally, it is clear that business leaders are enduring levels of scrutiny and pressure unprecedented in recent history.

The Booz Allen global study, across 2,500 of the world's biggest companies showed that worldwide, the number of CEOs sacked last year soared by 69%. Whereas in 2001, 'forced' CEO changes accounted for one in four of all changes at the top, one year later firings represented 39% of all such successions. Firing of under or poorly performing CEOs also more than doubled from 1995 to 2001.

### Exhibit 1

### Global Rate of CEO Turnover

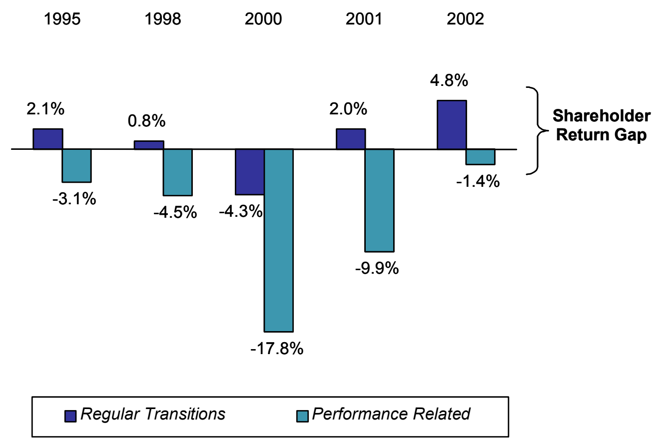



*Note: Figures above column represent percentage of firms that experienced a turnover event. Figures within columns are the breakdowns by type of turnover event*

The global findings also suggest that shareholders are judging CEO performance more harshly. CEOs who were dismissed in 2002 generated shareholder returns only 6.2% lower than chief executives who voluntarily retired. In 1998, it took an 11.9 percentage point incremental difference to prompt a firing. In short, CEOs are being shown the door for performance shortfalls that may previously have been tolerated.

### Exhibit 2

### Median Annual Relative Shareholder Return During Full CEO Tenure




*Note: Normalised for Returns in Region*

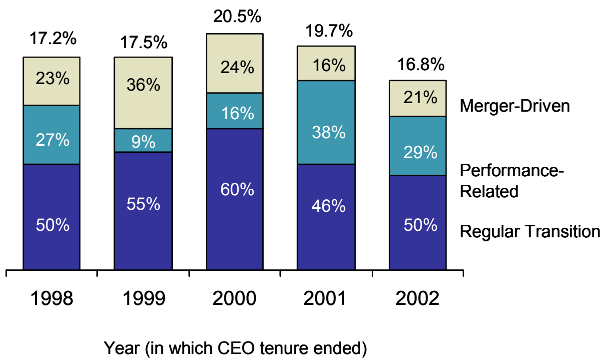
The global figures show the extent to which shareholder activism and changes in corporate governance have transformed the CEO's world. The cult of the CEO appears to have run its course. The market is increasingly eschewing personality for more tightly buttoned-down, mind-the-farm business sense. Emphasis is on restructuring costs and working down debt whereas bold strategic moves and acquisitions have taken a back seat.

## 3. The Australian Context

In Australia, there are notably more CEO transition events driven by M&A activity. Against the global average of 14% as a rationale for CEO succession, in Australia 21% of succession events could be classified as merger related. Compared to the previous year the percentage of merger driven CEO events was up by 5% in absolute terms. This trend is likely to continue going forward. The first half of 2003 has already seen a significant increase in the number of mergers and acquisitions launched. In fact, mergers and acquisitions are numerically up 50%.[2]

### Exhibit 3

### Australian Rate of CEO Succession 1998-2002




*Note: Figures above column represent percentage of firms that experienced a succession event. Figures within columns are the breakdowns by type of succession event*

The M&A activity has been influenced by the relative strength of the local economy and the value of the Australian dollar.

In Australia, in 2002, companies sought to take advantage of the depressed share prices and industry fragmentation as an opportunity to drive scale advantages on the back of lower market valuations.

In Australia's smaller and increasingly consolidated market, the pressure for growth puts local CEOs under the gun to explore mergers and acquisitions overseas.

Chasing growth via mergers and acquisitions, especially offshore plays, always entail a higher execution risk. Almost half of the performance related turnover events resulted from failed endeavours to manage offshore acquisitions.

[2] *Source: Thompson Financial*

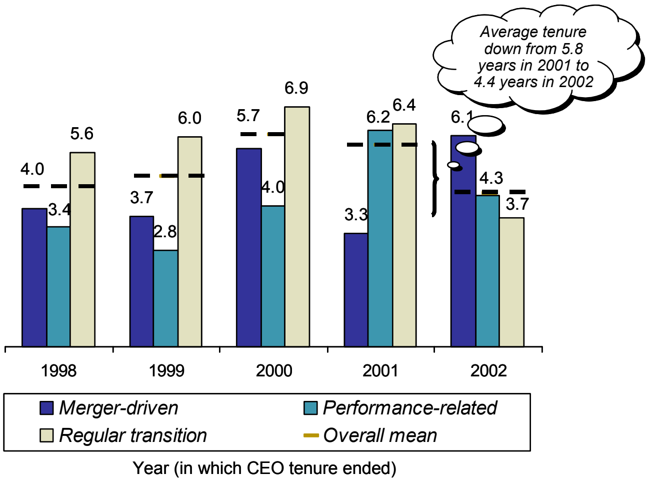
## Tenuous Tenure

Australian corporate leaders have, on average, a significantly shorter tenure and have therefore less time to devise and execute their change agenda.

In the short space of time from 2001 to 2002, the mean tenure of departed CEOs declined significantly. Average CEO tenure in Australia is now 4.4 years, almost half that of their global peers (8.6 years). It is also getting shorter, having declined from 5.8 years in 2001.

### Exhibit 4

### Mean Tenure of Departed CEOs in Australia




*Note: Regular transitions are unusually low in 2002, driven by a number of short CEO tenures (eg ING)*

The average tenure of CEOs who leave because of underperformance is a mere 3.6 years. Therefore local CEOs have just a two-year window to deliver. If they deliver negative returns after two years, their overall tenure is at risk.

The implications are that the first 100 days are even more crucial to deliver against for new CEOs when mapping out their strategy based transformation program.

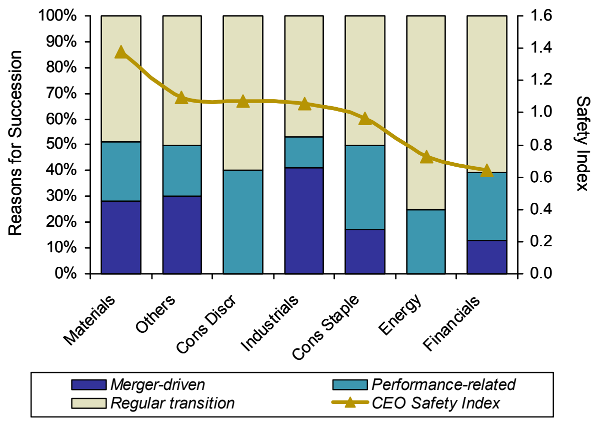
## Some Industries are Safer than Others

The "CEO Safety Index" – the proportion of CEO turnover in an industry divided by the proportion of all CEO turnovers in Australia, identifies the relative security or otherwise of chief executives in different sectors. In Australia, as well as globally, financial services is the 'safest' sector.

Globally, during the period between 1995 and 2002 the financial services industry also had the lowest CEO turnover overall (6.6%) and the fewest forced departures (1.5%).

### Exhibit 5

### Rates and Reasons for CEO Turnover by Industry in Australia



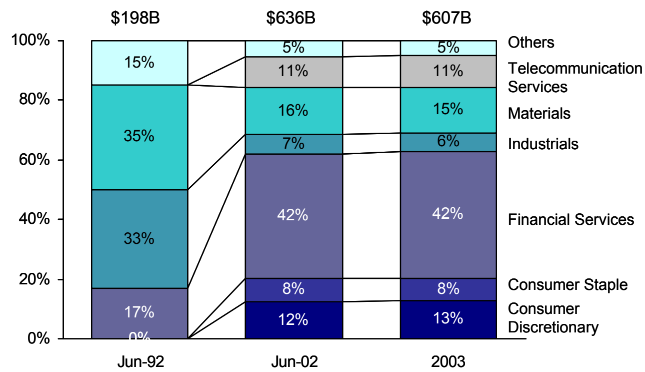

*Note: CEO Safety Index is the proportion of CEO turnover by industry divided by the proportion of turnover events at the top 2,500 companies in each year globally*

Stability, market growth and a rising share price all contribute to the likelihood of CEO survival. There is little surprise that the increase in market capitalisation of the financial services industry over the last ten years has created the greatest prospects for CEO longevity.

Overall the Australian financial services sector has been very successful over the last decade. Today, financial services account for 42% of total market capitalisation of the top 100 in the ASX, compared to 33% in 1992.

### Exhibit 6

### Market Capitalisation by Sector in Australia (1992 – 2003)




The unparalleled growth of the financial services industry in the last ten years demonstrates the sector's ability to innovate and find new sources of value through growth opportunities provided by the macro economic environment.

In Australia, the highest incidence of turnover events occurred within the materials sector. This higher level of turnover reflects the relatively higher amount of merger activity in that sector.

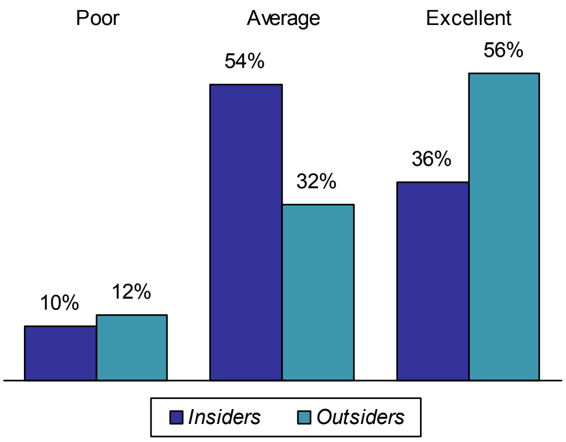
## The Outsiders – Out or In?

Recruiting a new CEO from outside the company often triggers controversy and a heated debate among stakeholders. On the one hand, outsiders are perceived as “fresh blood" with new management ideas and the ability to implement new approaches. Others criticise outsized pay packages, huge promises and high expectations attached to those brought in from outside, especially when recruited from overseas.

Globally and locally, the findings show that both supporters and critics of ‘outsider’ hires are correct. Outsider CEOs disproportionately produce both excellent and poor results both globally and in Australia.

### Exhibit 7

**Performance of Insider and Outsider CEOs in Australia**




*(1) Poor performance = Adjusted returns less than -10% per year for full tenure*

*(2) Excellent performance = Adjusted returns greater than +10% per year for full tenure*

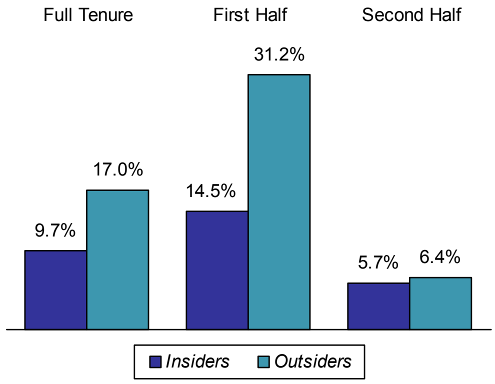
Insiders tend to produce average results, whereas results from the outsiders tend to be more extreme. The key difference between outsiders and insiders is timing. Outsiders perform much better in the first half of the tenure.

The “second half” slump is a significant challenge confronting all CEOs. The reason for this trend may involve the fact that new CEOs launch an effective change program that delivers above average results in the first half of their tenure, but have difficulty in maintaining the same performance over time.

Outsiders are likely to be given more latitude by boards to take rapid write downs, allowing companies to show early appearance of financial success through a burst of activity, such as acquisitions. Most outsiders do shake up the organisation, initially creating beneficial change, but find it hard to sustain this for a number of reasons, including the absence of internal support networks.

### Exhibit 8

**Median Relative Shareholder Returns of Insider Vs Outsider CEOs in Australia**




*(1) Outsiders defined as someone hired from outside the company into the position of CEO excludes executives hired from outside and groomed for CEO*

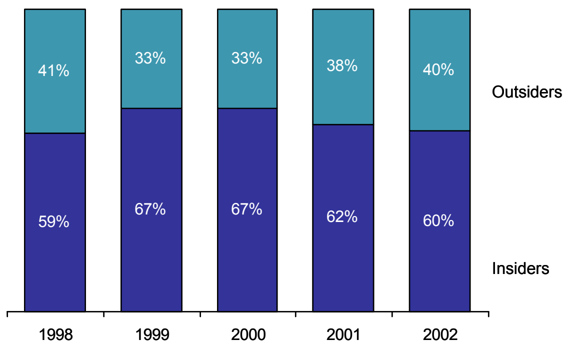
*(2) Insiders sample size of 39 and outsiders sample size of 25 for the departed CEOs in the ASX 100 list 1998-June 2003*

In Australia, succession from within the company continues to be the main source of CEO talent, making the need for best practice succession planning all the more pressing.

In 2002, 60% of the CEOs were hired internally. However, during the past three years there has been a trend towards hiring CEOs from outside the company.

### Exhibit 9

**Internal or External Source of Succession in Australia**




*Note: Sample size includes ASX100 companies for which data was available*

## 4. Australian Trends in Perspective

In any economy, structural market conditions, in addition to the global economic climate, have an impact on CEO tenure. In the case of Australia, CEO tenure in recent times appears to be driven by two contradicting trends.

It is likely therefore that the findings of this survey have been significantly influenced by the relative recent health of the local economy – that over the period 2000-2002 the rate of local CEO turnover has been artificially held down by the buoyancy of the local economy.

Unprotected by such growth, Australia may have experienced even higher CEO turnover. The second factor relates to the size, rather than the relative performance, of Australia's economy. Australia is a small market and geographically removed from the main centres of the global economy.

To address issues of scale required to compete effectively in the global market, mergers through domestic industry rationalisation and also global takeovers have become more frequent. As the world markets continue to rationalise through globalisation Australian companies are attractive takeover targets.

Not surprisingly, therefore, the study has found that CEO succession events in Australia are disproportionately driven by merger activity.

### 5. Deliver or Depart – Booz Allen Hamilton Key Messages

#### Australian CEOs have a shorter tenure than their global peers

This implies that there is less time to act and more to achieve. In the first 100 days, it is critical for new CEOs to define their strategy quickly and base it on realistic performance targets and an appropriate time horizon for delivery. Given the short timeframe, a change management team capable of delivering on the agenda needs to be instituted and maintained over a period of time. Tracking and evaluating the performance of the change management program against the strategy plan through multiple sources, monitoring process as well as results may help to avoid the second-half of tenure slump in CEO performance.

#### The market rewards consistent performance

More conservative management models are in vogue after the end of the bull market. Steady performance yields greater longevity than a spurt of strong performance followed by a steep decline. Short-term fixes do not guarantee CEO tenure unless this marks the beginning of a longer-term continuous improvement. The global and Australian research also indicates that long-tenure CEOs set realistic expectations from the start, and sustain performance to fulfil expectations. In short, successful CEOs know where to set the bar. Incoming CEOs must avoid both mistakes and surprises. Sustaining change and persistently exceeding the market's expectations will continue to be the hallmark of all enduring CEOs.

#### Individual leadership still matters

In their rush to demonise CEOs some critics have concluded that the major forces determining corporate performance are institutional and macroeconomic. While the "cult of the CEO" has all but evaporated, leadership style, individual skills and personality of a CEO remain central to the company's ability to achieve alignment and successfully drive change.

#### The board can also act as coach and counsellor as well as judge

Boards are often primarily asked to shoulder greater oversight of corporate performance. But rather than being mired in faulty wiring, directors should strive to help chief executives overcome the challenges most are confronted with: sustaining above average returns in the longer term, helping CEOs – particularly outside recruits – understand the companies heritage and culture, and guide CEOs in bringing all stakeholders to make change last.

For CEOs this means that they need to actively engage boards and communicate their strategic plans, to ensure directors understand the complexities involved in executing change. CEOs need to reflect jointly with their boards on how to create a success story, and learn how to monitor the effectiveness of their working relationship.

### Methodology for the Global Study

This study required the identification of the world's 2,500 largest public companies, defined by their market capitalisation on 1 January 2002. Market capitalisation rather than revenue was used because of the different ways financial companies recognise and account for revenue.

The Compustat/Global Vantage database of public companies provided a list of all publicly traded companies on 31 December 2002.

To identify the companies among the top 2,500 that had experienced a chief executive turnover event, a global business-to-business contact database of executive decision makers (idEXEC) was utilised. This was augmented by an extensive literature review of the leading financial press and research engines as well as accessing the global Booz Allen research capability.

Each company that appeared to have experienced a CEO change was then investigated to confirm that a change had occurred in 2002 and for identification or confirmation of the outgoing executives key details. Information about the outgoing executive collected included: title upon succession, starting and ending dates of tenure as chief executive, age, education, whether an insider or outsider immediately prior to the start of tenure, whether he or she has served as a CEO elsewhere prior to this tenure, and the true reasons for succession.

Average growth rates (cumulated annual growth rates for total tenure, first half and second half) were calculated for two types of financial and shareholder information for executive's tenure: net income and total shareholder's return. Net income was provided by S&P (Custom Projects), quarterly data was provided by North American-traded securities was also collected and annual data was provided for other firms.

To enable meaningful cross industry comparisons, income data information for the relevant industry and region, total shareholder returns (TSR)[3] data was provided by Thomson Financial Datastream. Regionally adjusted TSR annual growth rates were calculated by subtracting the Morgan Stanley regional shareholder return indices from the company's performance during the period in question.

### Methodology for the Australian Study

The study required the identification of the ASX 200 companies since 1998. The data set for Australia includes 178 unique companies since 1998. In 2002, 143 companies in the ASX 200 were researched to determine if and when CEO turnover event took place. This approach was replicated for all the ASX 200 companies since 1998.

To identify the companies among the ASX 200 that had experienced a chief executive turnover event, annual reports and press search for each individual company were used. Annual reports provided information on the CEOs in each of the financial years and press searches were used to complement the data from annual reports and confirming the CEO turnover event and reason for the turnover. A variety of printed and electronic sources including *Lexis Nexis, AFR, SMH, BRW*, etc was used. Additionally *Factiva* for any announcement of retirements or new appointments of CEOs, presidents and MDs for the ASX 200 companies in each year since 1998 was used. TSR data were provided by *Datastream* and included capital gains, dividends and reinvestment of dividends.

Each company that appeared to have experienced a CEO change was then investigated to confirm that a change had occurred in 2002, for identification of the outgoing executives key details and the true reason for the turnover event.

Consistent with the global study we identified three reasons for a CEO transition event, ie *merger based*, in which a CEOs job was eliminated after an acquisition, *regular transition*, which included planned retirements, CEOs acceptance of a better position elsewhere, health related departures or death in office and *performance related,* which included any departure initiated by the board, attributed by the media to poor financial or managerial performance, or where there was a demonstrable performance shortfall but described as "personal reasons" in press.

### Australian Companies Surveyed

In 2002, 22 Australian companies within the ASX 200 that experienced CEO turnover events were identified. The majority of these events were in the consumer discretionary and material sectors.

A number of these events were particularly high profile, eg AMP, Suncorp, Lend Lease, Billabong, Mayne and BHP.

Merger activity played a role in the materials sector with the BHP & Billiton merger, Newmont's acquisition of Normandy and Goldfields merger with Delta Gold Limited, whereas in consumer discretionary, performance tended to be the key driver for CEO Turnover.

---

[3] *The TSR calculation includes both share price appreciation and dividends*

**About Booz Allen Hamilton**

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for more than 80 years. Booz Allen combines strategy with technology, and insight with action, working with clients to deliver results today that endure tomorrow.

With 12,000 employees on six continents the firm generates annual sales of US$2 billion, Booz Allen provides services in strategy based transformation, organisation, operations, systems, and technology to the world's leading corporations, government and other public agencies, emerging growth companies and institutions.

Ian Buchanan
Chairman, Australia New Zealand & SE Asia

Marion Skulley
Director, Strategy

Sydney
Level 7, 7 Macquarie Place
+61 2 9321 1900

Melbourne
101 Collins Street
+61 3 9221 1900

**About the Business Council of Australia**

The Business Council of Australia is an association of Chief Executives of leading Australian corporations.

The Council was established in 1983 to provide a forum for Australia's business leadership to contribute directly to public policy debates in order to build a better and more prosperous Australian society.

The Council's aspiration is to make Australia the best place in the world to live, to learn, to work, and to do business.

John Schubert
President

Katie Lahey
Chief Executive

Melbourne
Level 16, 379 Collins Street
+61 3 9610 4222