SpencerStuart

Chief Executive Officer

When an Executive Chair Helps or Hinders Company Performance

Four ground rules for using the role effectively

Planning for the succession of a successful, long-serving CEO or, trickier yet, a founder CEO is a difficult topic for any board. It is even more personally challenging for many CEOs.

One succession approach on the rise in the U.S. over the last decade is to name a new CEO and transition the former CEO into an executive chair (EC) role, ideally retaining their expertise and experience while the new CEO gets up to speed. Observing this trend, we decided to explore a fundamental question, “Does having the outgoing CEO transition to an executive chair enhance business performance?”

For context, just over 130 U.S.-based public companies with a market cap of at least $500 million have an executive chair today, but their numbers are growing; 50 percent more executive chairs assumed the role in 2019 compared to 2010. On average, executive chairs serve in the role for just over two years.

So, how are these companies performing? When we examined the performance of companies with executive chairs over the timeframe of the executive chair's tenure, we found that more than half — 55 percent — underperformed[1] their peers, by an average of 17 percent. But the 45 percent of organizations with executive chairs that overperformed really overperformed — by an average of 28 percent.

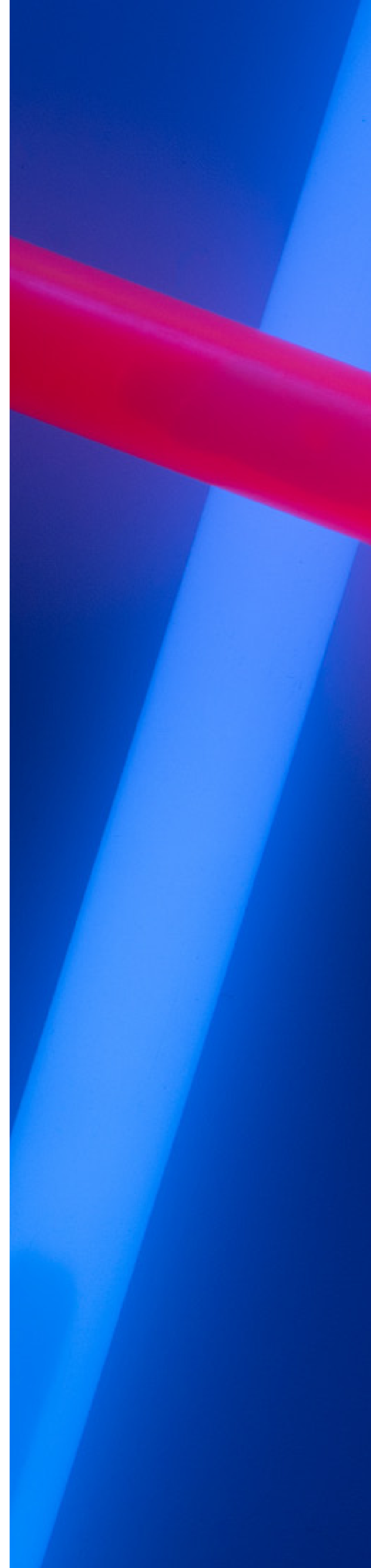
Our research suggests there can be real upside to having an executive chair — when done right. To learn more about how to manage a successful transition to executive chair, we spoke with executives who have been through this journey — the good and the bad. We wanted to understand how the CEOs and executive chairs avoided the risks of having two prominent leaders at the helm and to glean what they might have done differently looking back. Here are four main ground rules to consider if contemplating this path:

1. The handover should be clear, visible and rapid.
2. Building trust is key to success.
3. The exec chair and CEO need to be clear about the division of labor.
4. The board should be built around the needs of the new CEO.

1 There can only be one CEO, so the handover should be clear, visible and rapid

A recurring theme shared by those who got it right is that a successful transition requires the unwavering support of the outgoing CEO. If the CEO is having second thoughts about transitioning out of the role, or has even the smallest interest in retaining operating authority, alternative succession plans should be considered. Approaching the role with the right intention is crucial for success. This is not a shared CEO role.

To build an effective CEO/EC relationship, it is imperative that the executive chair's only interest is seeing his or her successor succeed. It cannot be about defending legacy or protecting the status quo. There can only be one CEO, and it must be clear to both the internal organization and outside shareholders who that is. The board and outgoing CEO will need to accept that the new CEO will do things differently, sometimes casting his or her support behind different strategies or leaders. Many successful exec chairs have shared the belief that the board needs to be clear and unwavering in their encouragement and backing of the new CEO and celebrate new ideas and ways of working.



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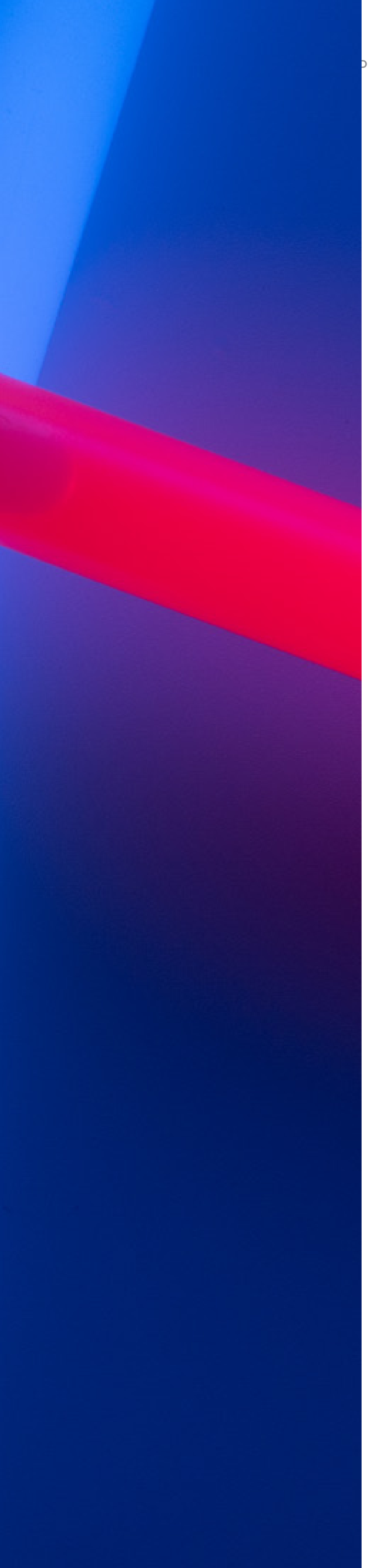
1 Performance was measured using CAGR which discounts performance by the number of years and is not purely cumulative as opposed to TSR. We then compared average company CAGR values over the executive chair's tenure to the average CAGR of their relative peer group. Peers were generated using S&P Capital IQ's back-end algorithm that factors in (1) analyst coverage (2) financials/trade price requirement (3) company location (4) revenue and (5) industry coverage. Companies with executive chairs that are public, U.S. based, and have a market cap of +500M were included in the analysis.



The outgoing CEO should reinforce the handover in decision-making power with visible cues to the organization, for example, giving the new CEO his or her office, reminding former direct reports to go to the new CEO, removing themselves from CEO distribution lists and limiting attendance in regular executive meetings. Successful executive chairs told us that these informal actions have a big impact on the organization's view of and belief in the successor. When they see the visible support of the successor by the board and the exec chair, the larger organization can more rapidly align behind the new CEO.

Further, one recent exec chair reinforced the need to make the handover quickly. A slow release of responsibility is likely to confuse the organization and reduce the success of the next CEO. Moving quickly does not just refer to the initial transition, but also when the executive chair transitions out of the role. Our research found that companies tend to have superior performance when executive chairs have shorter tenures (less than a year).

2

Internal or external, trust has to be paramount

As one executive chair put it: "The most important thing is to find the right successor. Nothing takes the place of having the right person in the role. Lay the groundwork and make sure you are ready for it."

The board's responsibility in succession is paramount and the board, not the outgoing CEO, should independently and objectively determine whether an executive chair structure is right for the company. Our longstanding CEO succession research work points to little correlation between performance and whether the successor was promoted internally or hired from outside the organization, so boards can separate the decision about whether to have an executive chair from the decision to promote from within or hire an external successor.

The board also should consider how much of a role the outgoing CEO should play in the succession process, recognizing that he or she may have a potential bias in favor of an internal candidate or against a change agent or someone who is quite different in style or approach. Finally, one board member confided to us that knowing the outgoing CEO would be staying on as executive chair made the board much more willing to select a new CEO who had a similar profile but was not ready and was not rigorously assessed. Because directors felt he could be mentored into the job by the outgoing CEO they selected him. On reflection, that CEO was not ready and the company now has a new CEO in place after a thorough search and onboarding process.

It is important to be transparent during the hiring process and explicit about what the transition and division of responsibilities will look like and how the board will intervene if it is not working. Candidate skepticism about why an executive chair role is needed or how the division of responsibilities will work is natural, but you do need an incoming CEO who welcomes the additional support. However, if the rationale for or scope for an exec chair transition isn't landing well with potential CEO successors, it is worth considering why that is: whether the candidate has the right approach, the plan needs adaptation, the executive chair role is structured right or the executive chair's attitude is problematic.

Whether the successor CEO comes from inside or outside the organization, trust between the executive chair and the new CEO is critical to a successful outcome, our research shows. Outgoing CEOs have the opportunity to start building trust with internal successors by beginning to offload duties to their successor in advance of the formal transition. While it is undoubtedly easier to feel confident handing over the reins to someone already in the organization, a number of executive chairs who were succeeded by an external hire all emphasized the importance of treating the new CEO as "one of your own."

3

Who does what? Be clear about the division of labor

In addition to building trust, the executive chair and new CEO must have an explicit conversation about who owns what functions and responsibilities. Our research finds that the transition is more likely to be successful when the outgoing CEO is clear about how long he or she expects to be in the executive chair role, what he or she will and won't spend their time on, and how he or she envisions the partnership working. Here are a few tips from those who have been through it:

- First and foremost, establish that the CEO is the ultimate decision maker. The executive chair should look to them for direction on how to best add value.
- Make sure the executive chair's activities are transparent to the CEO.
- The executive chair should involve themselves in areas where they can be helpful, but not in activities that should be part of the CEO's purview. Executive chairs can make themselves available to the CEO to answer questions such as: I'm looking at this acquisition — what are your thoughts? Would you meet with someone in your external network to get their perspective? Should we make an appearance at this event? What are your thoughts on making this org restructure?
- View the executive chair role as being like that of a coach or mentor.
- Before involving themselves in something, the executive chair should consider: How is this leveraging the current CEO? The executive chair should be available to help make the decisions but understand those decisions (for good and bad) are ultimately not his or hers to make.

Executive Chair Responsibilities

In this unique role, the exec chair is a non-independent member of the board and a member of management, making it even more important to clearly define the specific responsibilities of the role. Here are the most common responsibilities of an exec chair from a variety of successful transitions:

- Advising during the transition of the chief executive officer
- Focusing efforts on corporate strategy, strategic customer and partner relationships, and corporate development
- Signing financials
- Managing specific projects (JV, partnerships, new product launch, etc.) and other assignments delegated by the board
- Attending meetings as needed with the board, company leadership, business partners, vendors, employees and others
- Subjecting oneself to normal governance procedures relating to board membership
- Assisting the board with its oversight of the company's risks
- Communicating to both internal and external stakeholders, as appropriate
- Acting as a liaison between the board and management
- Creating alignment with the board and management and supporting the execution of the strategy
- Setting the board meeting calendar and general board oversight
- Setting the agenda for board meetings (in partnership with the CEO and the lead independent director)
- Presiding over the company's regular meeting of shareholders

4 Keep in mind whose board it is

It is important that all parties involved recognize that the CEO needs to be clear with the lead independent director or chair of the board about what skills, experience and style will be most helpful for the executive chair to emulate. Further, the new CEO should develop a strong relationship with the board and individual directors — the lead independent director, in particular — and not allow the executive chair to become a gatekeeper to the board or to heavily influence board composition. To be effective, the CEO needs to know and respond to the questions the board has about the company's challenges and the leadership issues the CEO is facing.

The executive chair plays an important role in setting the right tone for the board and new CEO. He or she should ensure the CEO is presenting and directing the conversation with the board. One executive chair noted how his CEO found it helpful to meet before board meetings to get guidance on potential hot spots with certain board members. Finally, one recommendation from a CEO and exec chair who had a particularly good relationship with the board was to have a regular cadence of discussions with the executive chair, CEO and independent chair/lead director and, in their case, the chair of nominations and governance committee, to candidly discuss the aspects of the exec chair and CEO roles that were and were not working.

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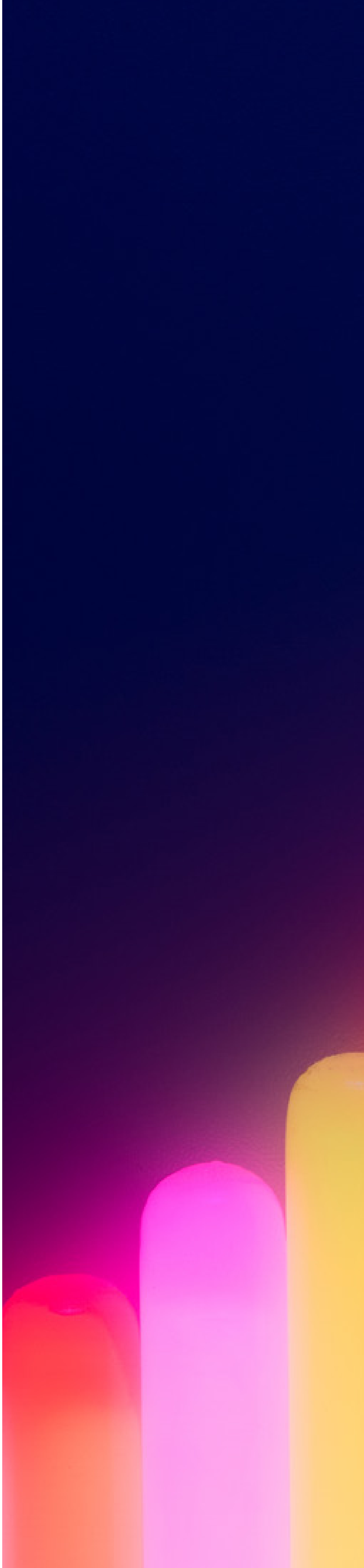
While it is tempting for boards to assume that adding an executive chair will reduce the risk associated with a CEO transition, our analysis suggests it is a more complicated decision that should be made case by case. That being said, when the transition is done right, an executive chair can be a huge asset to an organization and we expect to see more boards adopting the executive chair model, given the potential for enhanced value creation. We also believe that the continued pressure for split CEO and chair roles will spur more boards to name an executive chair to help keep outgoing CEOs close. However, it is important to note that deciding to use the exec chair role as part of your succession plan is not just to avoid poor performance but to actually outperform which has not been the case for many of the boards that have taken this approach. Hopefully, these tips from those who have created value — and those that have struggled — will provide the insight CEOs and boards considering the role of the executive chair need to make the best decision for their companies.



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AUTHORS

Jason Baumgarten (Seattle) and Amitabh Sharma (Silicon Valley).

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