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Lessons from forced CEO exits

The average tenure of CEOs in Australia has fallen dramatically in recent years, with a lasting impact on share prices from CEO exits for non-financial reasons

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It looks as though Australian boards of directors need to redouble their efforts to understand the culture, governance and environmental issues bubbling away inside their companies.

That is one conclusion to be drawn from a study of 300 chief executive departures from listed companies over the past 10 years by global management consulting firm Kearney.

Gerd Schenkel says as community expectations change, boards are going to have to reflect that in their deliberations and the way they hold CEOs accountable. **David Rowe**

The study, shared exclusively with Chanticleer, compares CEO exits over two five-year periods – from April 2011 until March 2016, and from April 2016 to March 2021.

The total number of exits remained flat over the two periods, but the number of exits was relatively high compared with global trends. About three-quarters of CEOs transition in a five-year period.

The Kearney study found the number of involuntary exits increased by 27 per cent over the two periods and the share of involuntary exits of all exits is now 34 per cent.

The forced exits were put into two buckets – financial performance and non-financial (environmental, social and governance) reasons.

Over the two periods, the number of involuntary exits for non-financial/ESG reasons rose almost fourfold. Non-financial reasons now account for 37 per cent of all involuntary exits.

Analysis of the share price impact of CEO exits found that most CEO departures seem to refresh investor confidence and boost the share price.

Boards need to be prepared for a forced CEO exit, as it is likely that this occurs at least once during a non-executive director's tenure.

— Gerd Schenkel, co-author of the Kearney study

But when it came to involuntary exits caused by non-financial/ESG reasons, the share price underperformed the broader index by about 5 percentage points one year after the transition.

The findings are pertinent given that several commentators in the past month have labelled ESG as the work of the devil. It is allegedly taken seriously only by lily-livered directors who have lost sight of the primacy of shareholder interests.

Gerd Schenkel, who co-authored the study with fellow Kearney senior partner Alasdair Johnston, says forced CEO transitions due to ESG reasons tend to reflect deeper structural issues within the organisation.

He says social media is becoming an important factor in the forced CEO transitions, which are happening due to a broad spectrum of ESG reasons.

Social media echo chamber

"Social media echo chambers are playing a key role in amplifying stakeholder indignation in an unpredictable way and making it harder to anticipate where the hazards lie," he says.

Schenkel says boards face an increasingly complex landscape that requires increased sophistication in the tracking of ESG risks and the way in which companies respond.

"ESG is likely to undergo a journey similar to workplace safety. Change will only come from strong leadership, better processes and a fundamental shift in culture from the boardroom to the front line," he says.

"All the issues so far fall broadly under the social and governance aspects of ESG. We predict that environment will be next."

Schenkel says that as community expectations change, boards are going to have to reflect that in their deliberations and the way they hold CEOs accountable.

"There has been a sharpening of CEO accountability around issues that occur a long way from their office. They are on the hook for the culture of the organisation they lead," he says.

Schenkel predicts that boards will need to include a much broader set of risks in their risk management frameworks in order to avoid high-profile events that can lead to CEO departures.

"Boards need to be prepared for a forced CEO exit, as it is likely that this occurs at least once during a non-executive director's tenure at an organisation," he says.

This preparedness, including mature succession planning, involves having the right mix of people sitting around the board table so that its diversity reflects Australian society.

"The Friedman Doctrine to maximise shareholder value no longer holds when shareholders want financial returns delivered under a set of ESG conditions," Schenkel says.

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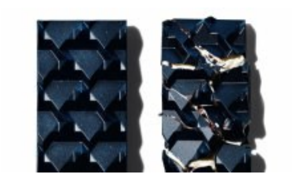

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