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MERIDIAN
COMPENSATION PARTNERS

Three Keys to Successful CEO Transitions

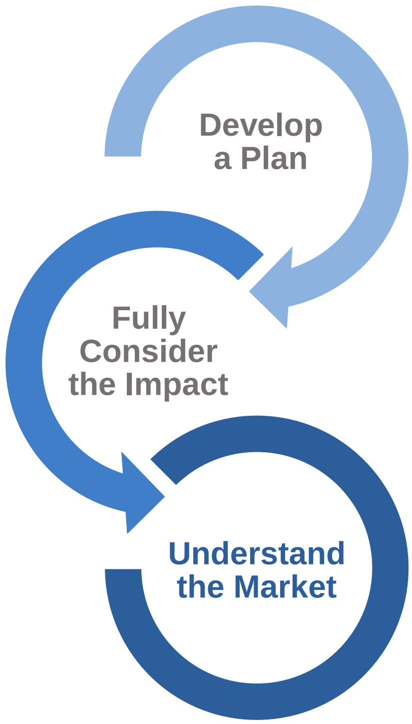
A certainty along with death and taxes, companies can be assured that at some point, they will have a CEO transition, whether as a result of retirement, resignation or firing.

This edition of the Meridian Beacon provides an overview of key points that companies should think about in advance, to help navigate these critical transitions.

#1 Develop a Plan (Aligned with the Type of Executive Transition)

The most common types of executive transitions result from one of: **retirement**, **resignation** or **termination**.

In each case, advance preparation is critical to addressing both employee and investor concerns quickly.



- **Retirement:** This is typically planned well in advance, with a mutual agreement on timing. The more difficult-to-manage questions will often be issues around the outgoing CEO’s role. Will they remain on the board? Will they take on the role of chair of the board? Are they required to provide some services for a transition period? How involved should they be in determining their successor? How should their outstanding equity be treated?
- **Resignation (or Medical Emergency):** This scenario often comes with little warning. This is the area where the company’s emergency succession plan should come into effect immediately. This plan should address:
  - **Communication:** Appropriate internal and external messaging.
  - **Interim CEO:** Appointment of interim leadership (sometimes a qualified board member, an executive who can be a steady hand during a CEO search, but who does not aspire to the CEO role and in those rare ideal cases, an internal, ready now candidate).
  - **Open Incentive Cycles:** Treatment of open cycles can be impacted by the circumstances that gave rise to the resignation balancing formal provisions with judgments around whether conservatism or magnanimity are best suited.
  - **Search Process:** This should be based on both pre-existing internal candidates’ development plans and an “evergreen” list of external candidates.

- **Termination (Firing):** This is generally planned at least somewhat in advance by the board/company (but may be highly unexpected for the CEO and their team). The most difficult questions tend to relate to timing. The external replacement candidate pool is typically small and well-connected, which makes it difficult to identify an external successor well in advance. The internal candidate pool is even smaller. All of this means that the general advance planning needs to be thorough.

#2 Consider the Full Impact of the Transition

A CEO transition impacts more than just the CEO. It includes executives who view themselves as potential CEO successors and all the CEO's direct reports are directly impacted by the transition. As well, a decision to promote from within the organization or hire externally can have significant implications to culture, retention of executives and business performance.

Except in the situation where a company has a "ready now" CEO successor (usually only in the CEO retirement scenario), the Board needs time to follow a proper process and to vet both internal and external candidates. In this situation, even though it may seem logical for the business, there is risk to appointing an executive with CEO aspirations to an interim role. This creates expectations that are likely to result in significant disappointment and often resignation if the individual is not appointed as the permanent CEO.

An internal promotion or an external hire is likely to significantly increase retention risk for the self-perceived CEO successors left behind. To a lesser, but still important degree, the broader executive team is at greater retention risk during and following a CEO transition. Strong communication, career plans, reasonable severance policies or agreements and sometimes retention compensation are just some of the tools a company may need to deploy to steady the ship, particularly on an unplanned CEO transition.

The two most important advance preparation tools for the Board are:

- A CEO emergency succession plan.
- Regular succession and talent development discussions.

#3 Understand the Market and Compensation

Compensation will generally start out differently for an experienced external CEO hire and an internally promoted executive. It is important to understand market compensation and other key employment terms, in advance of going to market or promoting internally.

Experienced External CEO Hire	Internally Promoted CEO
• Often compensation will be above market median to reflect the experience of the candidate	• Typically position pay at ~80%-90% of market median with a ramp up to full market median over 2 to 3 years, as the executive gains experience
• "Make whole" compensation often required for external hires, to compensate for equity forfeited at former employer – ideally match to risk level, equity type and vesting term of forfeited equity	• Top-up LTI award may be required on promotion
• Sign-on compensation may be required to entice the right candidate – consider a full-year LTI award instead	• Manage perceptions related to outgoing CEO compensation
• Special retirement terms may be required to manage special situations (e.g., late career hire, expected to have a shorter tenure, who will not meet retirement eligibility criteria)	• Consider ramifications for remaining executives who did not get the position – it may take a special consolation grant to smooth things over and keep them focused on the job at hand under the new CEO
• Compensation for an external CEO candidate can "rock the boat" for incumbent executives	• Likely less expensive than an external hire; but if internal candidates have a significant skills gap, an experienced external hire may be worth the costs

An external CEO hire is likely to result in higher overall compensation due to:

- **CEO Pay:** Likely to pay above market median compensation and may include "make whole" equity grants.
- **Severance:** New CEOs often will want to make changes to portions of current leadership team. For roles where the new CEO wants to bring on their own team members, plus often higher compensation for these new hires.
- **Retention Awards:** For unpromoted executives.

Remember: Meridian Can Help

Meridian stands ready to help companies navigate CEO and other executive transitions. We have assisted hundreds of executive transitions and can help determine the best approach for the situation. This includes designing pay packages for newly hired and newly promoted executives, as well as helping determine the appropriate severance (if any) upon various termination events. We have found that it is best for executive transitions to be tailored to the specific needs of each company. While general market practices exist, there are often company-specific reasons to vary such practices concerning individual executive transitions at a company.

Be sure to check out Meridian's podcasts **Your CEO Is Going To Leave at Some Point. Are You Ready?** and **How Should Compensation Decisions Be Managed During CEO Transitions?**

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