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# CEO Turnover Study in 2007

*The Performance Paradox*



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## About the Authors

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## INTRODUCTION

Following sustained growth since 2002, the global economy struck difficulties in 2007 as the U.S. subprime mortgage crisis emerged, causing instability in stock markets and among financial institutions in particular. Yet, despite the economic uncertainty unleashed, global CEO turnover in 2007 fell to 13.8% from the 2006 level of 14.3%, continuing the downward trend since 2005.

Counter to the global trend, the CEO turnover rate in Australia increased in 2007 to 18%, an increase on the 2006 rate of 13.4% and its highest point since 2000. The key drivers of this increase can be attributed to merger-driven and other planned transitions. Locally, merger-driven turnover is almost double the global level, with 5.3% of CEO departures in Australia caused by mergers. Planned transitions (planned retirements, acceptance of a CEO position elsewhere, health-related departures or death in office) have also increased from 7.5% in 2006 to a high of 10.5% in 2007.

The 2007 study runs counter to the perception that the corporate environment has evolved such that CEOs delivering sub-par returns in their first two years will be forcibly dismissed by their boards. It shows the link between poor short-term performance and CEO dismissal is not as strong as previously thought. This suggests an increase in recognition and greater acceptance of the time new CEOs will take to turn around business operations, especially during market downturns.

To understand how the global trends apply locally, Booz & Company again extended the annual Global CEO Turnover Study in 2007 to Australia, conducting an in-depth analysis of CEO turnover events at ASX 200 organisations supported by a number of one-on-one interviews with CEOs of listed companies.

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## Key findings of the Australian CEO Turnover Study:

- CEO turnover is currently significantly higher in Australia than globally. While global turnover has levelled off slightly in the past two years, falling to 13.8% in 2007 from 14.3% in 2006, turnover in Australia jumped to 18%, from 13.4% in 2006.
- Planned transitions and merger activity are driving higher CEO turnover rates in Australia, with only 2.2% of CEOs being forced to depart due to poor performance in 2007.
- Departing CEOs have performed better than at any time in the last eight years, with CEOs departing in 2007 delivering average total shareholder returns of 22% during their tenure.
- CEO tenure dipped to 5.7 years in 2007, down from the eight-year average (2000-2007) of 5.9 years, and significantly lower than the global average of 8 years over the same period.
- The proportion of internal candidates being selected to succeed departing CEOs is higher than at any time since 2000. Some 59% of CEO successors in 2007 were internal appointments.
- Externally-appointed departing CEOs delivered almost twice the returns of their internally-sourced counterparts in 2007, posting an average shareholder return of 32.3%.

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*“Booz & Company’s study this year suggests that compared to their global counterparts, Australian CEOs have less time to enact their strategic agendas.”*

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With CEO turnover increasing and tenure declining, Booz & Company’s 2007 study suggests that, compared to their global counterparts, Australian CEOs are afforded less time to execute their strategic agendas. The comparatively low rate of forced dismissal suggests board pressure may no longer play as big a role in departures as merger activity or the lure of a new challenge (or even retirement).

The growing tendency to appoint new CEOs from within suggests Australian companies have elevated succession planning, an issue highlighted in previous CEO turnover studies. The imperative for Boards and CEOs to plan for and execute a smooth succession remains. Succession planning can ensure a company avoids delays in making strategic decisions and maintains a steady operating pace at a time of CEO transition.

At the same time, externally-recruited CEOs continue to outperform internal appointments, indicating that succession planning initiatives may take time to bear fruit.

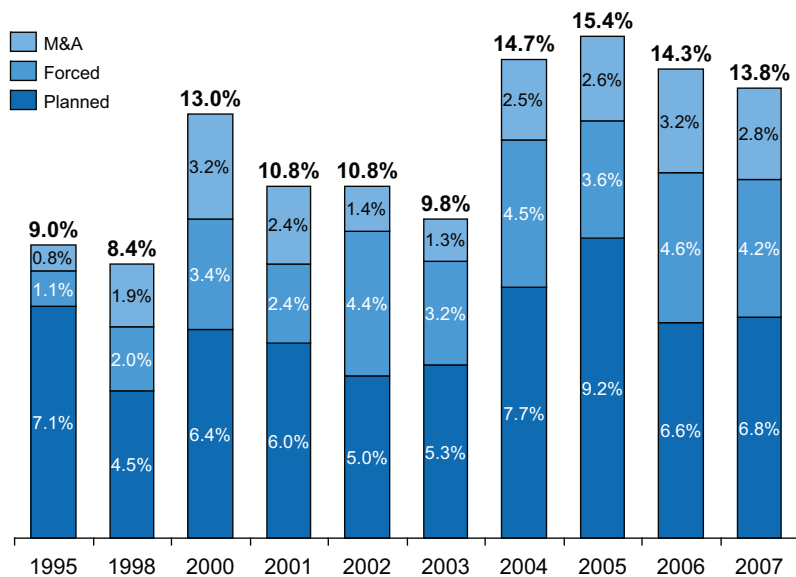
The improving performance record of departing CEOs, however, coupled with the higher incidence of planned departures, point to CEO retention looming as the next priority for Australian Boards. The key issue will be striking the balance between developing internal candidates and securing the benefit of experienced external recruits.

## Global Study: 2007 findings – The Performance Paradox

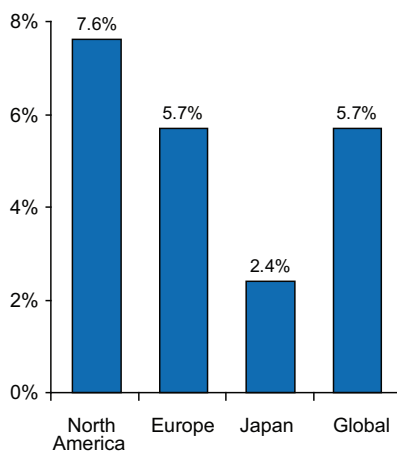
Over the last few years Booz & Company's study of CEO turnover has revealed an increasingly demanding environment for CEOs.

While the global economy remained steady in 2007 (recording GDP growth of 3.8% versus 3.9% in 2006, according to World Bank estimates) and is predicted to slow in 2008 (2.7% GDP growth according to the World Bank), the year saw a continued, albeit slight, fall in global CEO turnover to 13.8%. This is down from the high of 15.4% in 2005 and 14.3% in 2006. Yet the incidence of forced CEO dismissals remains over 58% higher than the 1990s average, confirming boards are more likely now to dismiss their CEOs than in decades past.

**Exhibit 1**  
CEO Turnover Rate by Reason  
1995-2007

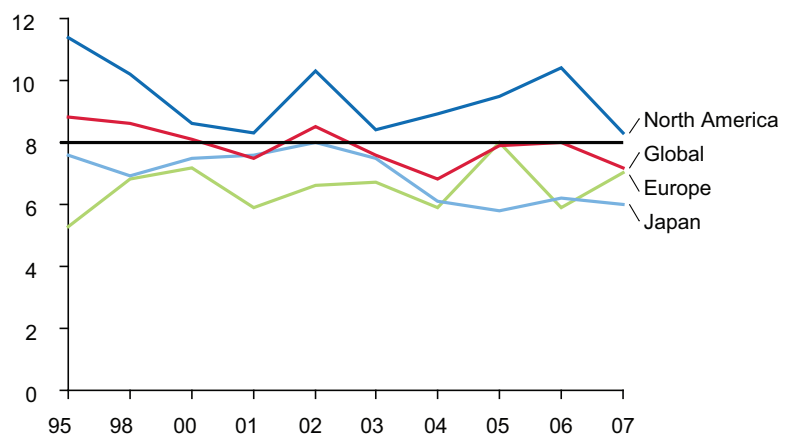


**Exhibit 2**  
Probability of CEO Termination<sup>(1)</sup>  
Organisations in the bottom 10% of absolute stock performance for 2 years



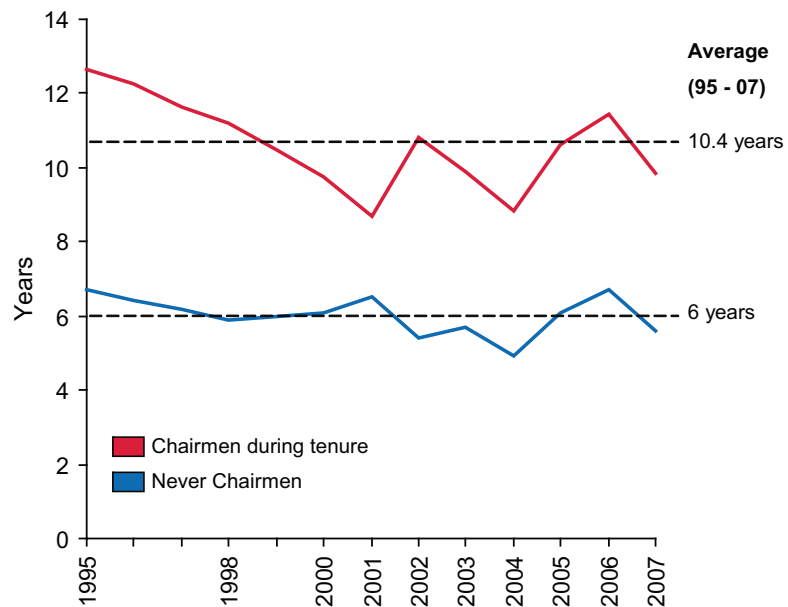
(1) Based on 10 years of data  
Source: Booz & Company

**Exhibit 3**  
Mean Tenure of Departing CEOs by Region  
Global mean tenure is consistently around 8 years, hence CEOs have time to execute their strategies

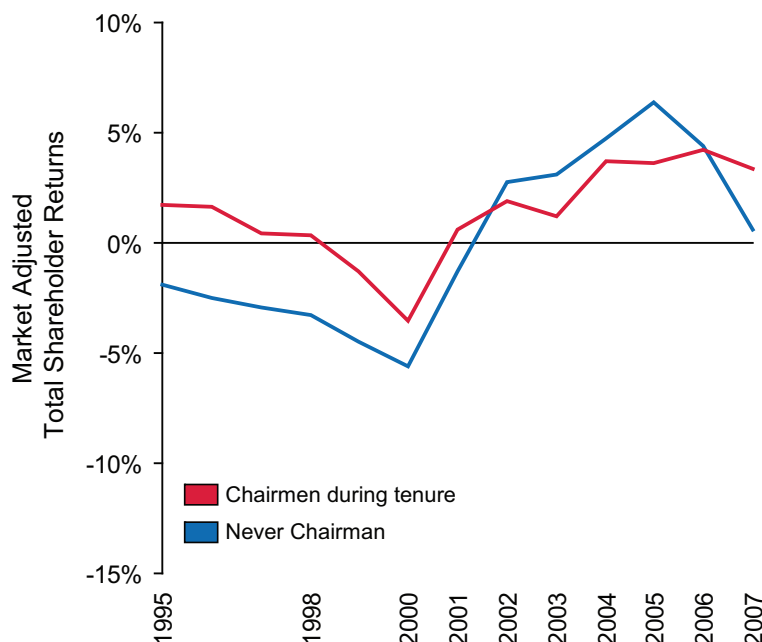


The common perception that boards have become more impatient, and willing to dismiss CEOs who are not delivering earnings growth in their first two to three years, remains pervasive. Our analysis, however, shows this not to be true. Mean global CEO tenure in 2007 was 7.2 years, consistent with the average of the previous 10 years. We would expect to see this figure decline if there was a trend toward CEOs being dismissed for not improving performance early in their tenure. Further, only 5.7% of poorer-performing CEOs (that is, those in the bottom 10% of absolute and market-relative stock performance for two years) were dismissed in 2007.

**Exhibit 4**  
Average Global CEO Tenure  
CEO/Chairmen and Never-Chairmen CEOs



**Exhibit 5**  
Global CEO Performance  
CEO/Chairmen and Never-Chairmen CEOs



While performance should ideally be the primary driver of tenure, the combined Chairman and CEO governance model – the ‘Imperial CEO’, prevalent in North America, where 75% of CEOs have held the Chairman title at some point of their tenure, and to a lesser extent in Europe – may also be a significant driver. Globally in 2007, departing CEOs who had never simultaneously held the CEO and Chairman titles had an average tenure of 5.6 years, compared to 9.9 years for those who had been Chairman at some point. This is despite there being no apparent performance advantage inherent to either model.

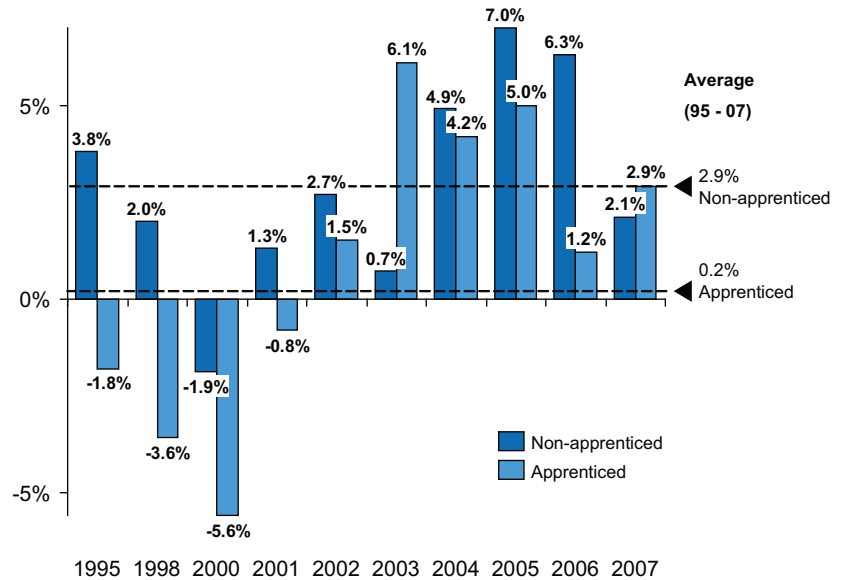
Another model common in North America is the ‘Apprentice CEO’, who begins his or her tenure while the outgoing CEO remains

on as Chairman (51% of outgoing CEOs in 2007 had been 'apprenticed', compared with 23% in Europe). Booz & Company's analysis suggests this model is correlated with relatively poor performance. Over the 10 years of data compiled for the Booz & Company studies, market-adjusted total shareholder returns for apprenticed CEOs were 2.7 percentage points lower than for non-apprenticed CEOs globally, and 2.5 percentage points lower in North America.

Finally, at a global level boards continue to demonstrate a strong preference toward appointing insiders to replace departing CEOs. A full 80% of new CEO appointments over the 10 years of Booz & Company's study data were sourced from within the organisation.

Yet over the same period globally, outsiders outperformed insiders by

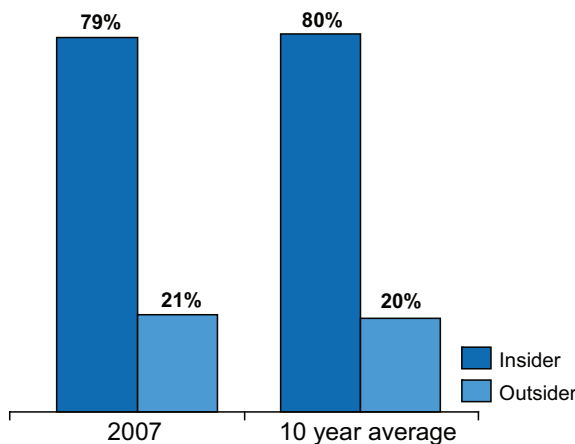
**Exhibit 6**  
Shareholder Returns of Departing 'Apprenticed' CEOs  
2000-2007



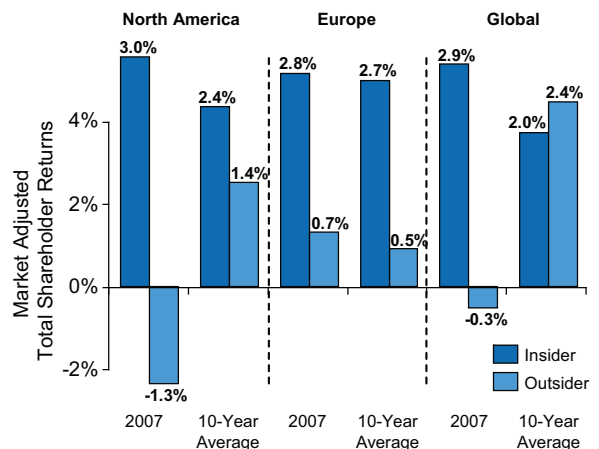
0.4% in terms of market adjusted shareholder returns over the life of their tenure. This trend was bucked in North America and Europe, where insiders outperformed outsiders by 1% and 2.2% respectively.

The global data raises questions regarding the degree to which boards outside of North America and Europe are adequately planning for CEO succession events. While boards have a very strong leaning towards

**Exhibit 7**  
Source of Successors to Outgoing CEOs



**Exhibit 8**  
The Performance Gap for Departing Insiders vs. Outsiders



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internal successors, the inferior performance of these CEOs suggests their talents have not been adequately developed prior to their ascension to the top job. This poses a question: should boards be emphasising internal leadership development and CEO training rather than planning for a successor who may not necessarily have the required capabilities?

Also questionable in light of the study's findings are some of the governance models prevailing in North America and to a lesser extent Europe, notably the Imperial CEO and the Apprentice CEO. Both models are shown to either deliver negligible improvement or have a deleterious impact on CEO performance, yet they continue to find favour and, in the case of the combined CEO and Chairman role, inflate overall tenure.

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*“Driving the increase in Australian turnover in 2007 were planned transitions, and a flurry of merger activity.”*

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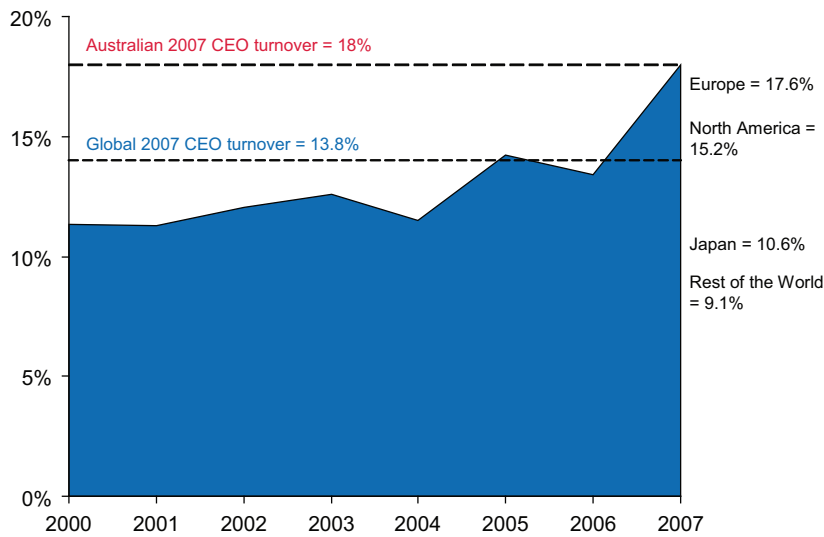
## AUSTRALIAN RESULTS

Once again, CEO turnover results for Australia should be viewed within the context of the Australian economic and structural environment.

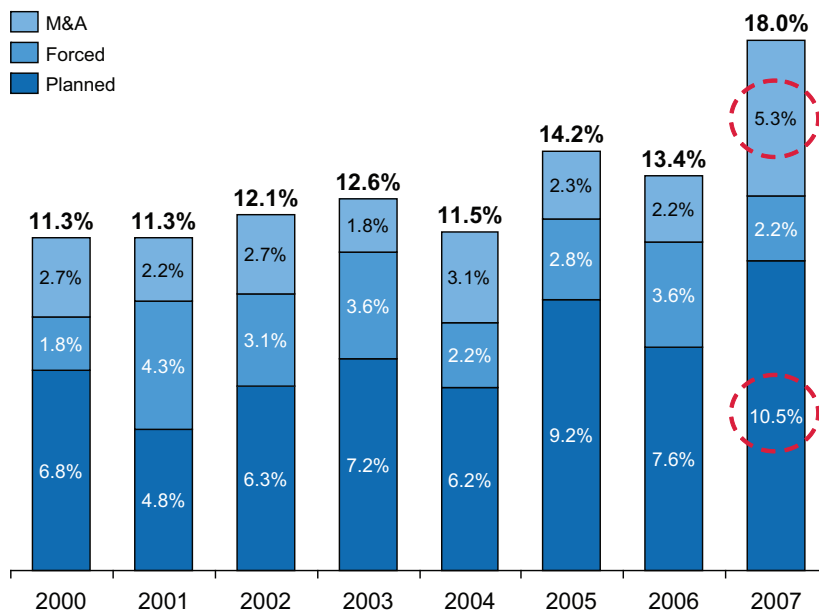
Australia's economy has sustained a steady growth trajectory since the early 90s, nominally outperforming other OECD economies during that time, with particular strength evident in recent years driven by the resources boom. Between 1992 and 2006, the annual growth rate for Australia was 3.6%, a full 1% above the average of 2.5% for OECD countries. With signs the economy may be entering a period of slower growth in line with the U.S. and global economies, growth in 2007 was strong.

However, being relatively small and isolated, Australia's economy is structurally quite different from many other OECD markets. For many organisations and industries, the Australian market lacks the scale necessary to support the sustained growth shareholders expect. Achieving such growth, coupled with the need to compete for capital on a global scale, frequently requires expansion into overseas markets. Such expansion exposes CEOs to commercial risks – for example, cultural differences, management over long distances, the complexity of multiple

**Exhibit 9**  
**Australian CEO Turnover Rate**  
 2000-2007



**Exhibit 10**  
**CEO Turnover Rate by Reason for Termination<sup>(1)</sup>**  
 2000-2007



time zones - that many of their counterparts in larger markets internationally do not face.

Consequently the Australian market (and for the same reasons, perhaps the European market) may be viewed as a more challenging environment for CEOs, placing downward pressure on tenure.

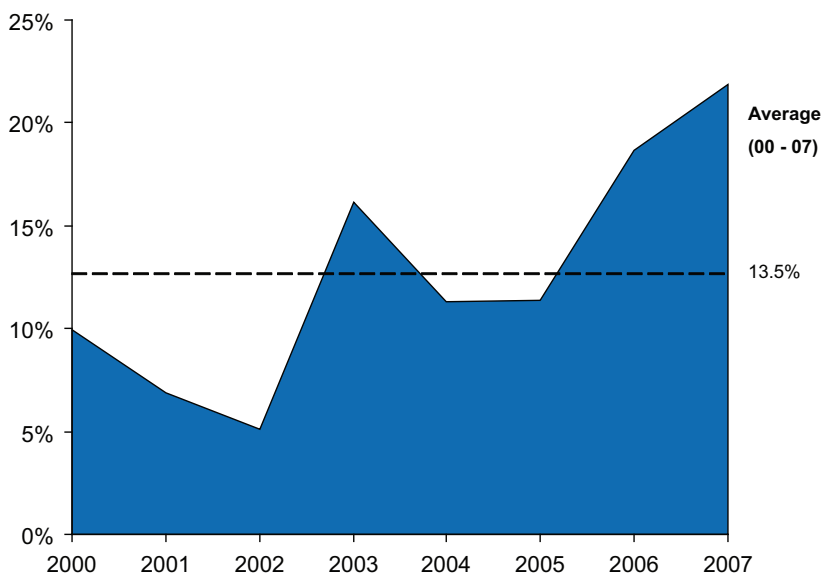
### CEO turnover in Australia – a contrast with the global picture

Australian CEO turnover in 2007 was 18%, the highest recorded since Booz & Company commenced the Australian study and an increase of 60% since 2000. At this level, CEO turnover in Australia was among the highest in the world and well above the 2007 global average of 13.8%, a figure which itself has fallen slightly since a 2005 peak.

Driving the increase in Australian turnover in 2007 were planned transitions, which have been trending upward since 2001, and a flurry of merger activity. Forced CEO departures in Australia remain relatively infrequent in a global comparison; only 2.2% of Australian CEOs were forced to depart in 2007, compared to 4.2% for their global counterparts.

Higher levels of planned and merger-related transitions, coupled with the downward trend in forced transitions, suggests the collective performance of Australian CEOs is improving. Data showing departing CEOs in Australia have increasingly

**Exhibit 11**  
**Annual Shareholder Returns of Departed CEOs**  
 2000-2007



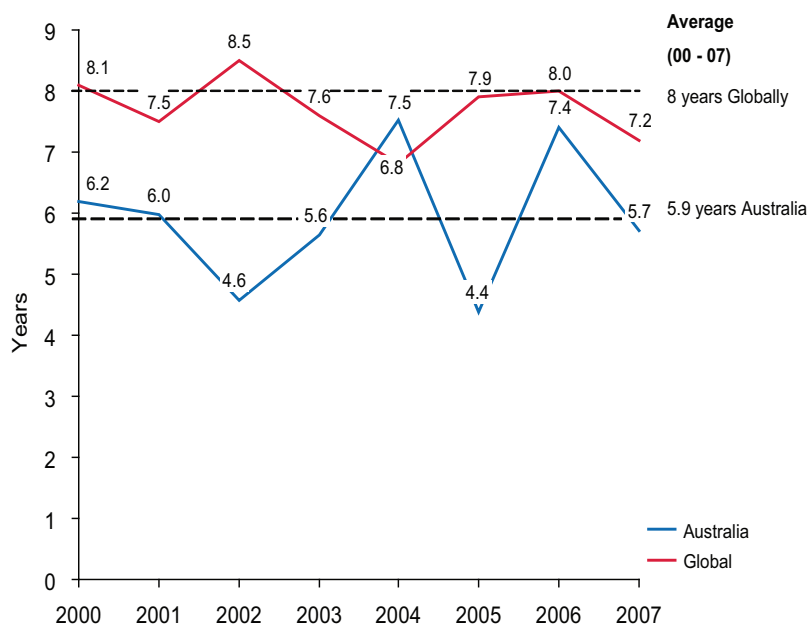
As in previous years, one factor looms as driving the gap between Australian and global CEO tenure: the predominance of the Imperial CEO model in the U.S, as noted in the global findings section. The relatively low incidence of this model in Australia (as in Asia and Europe) is a likely contributor to the lower CEO tenure locally.

delivered superior returns during their tenure support this hypothesis.

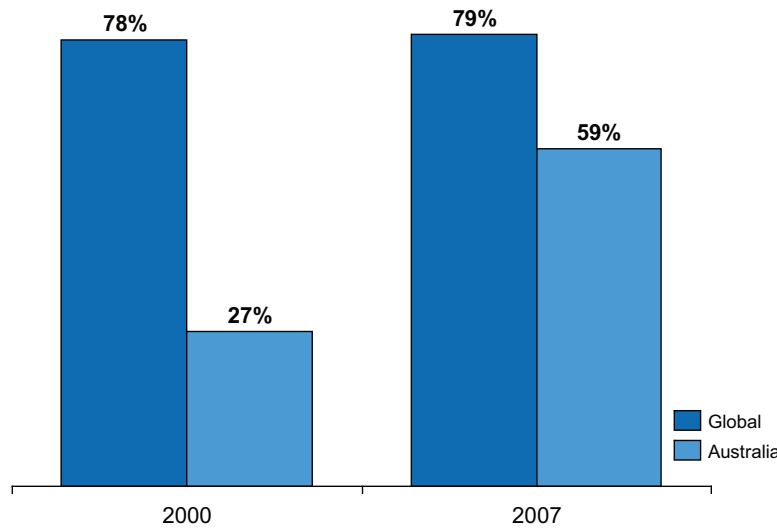
**Australian CEO tenure remains below the global average**

Continuing the trend of recent years, Australian CEOs are being afforded less time to execute their strategies than their global counterparts. At 5.7 years, the average tenure for Australian CEOs has stayed relatively constant since 2000, and below the global average of 8 years for the same period. In Australia, however, superior shareholder returns appear to be the positive flipside of shorter tenure, with the latter possibly acting as a catalyst for improving performance.

**Exhibit 12**  
**Mean Tenure of Departed CEOs in Australia**  
 2000-2007



**Exhibit 13**  
**% of Internal Successors to Departing CEOs**



**Replacing insiders with insiders**

In a trend gaining momentum over the past three years, Australian Boards continue to favour internal candidates when replacing CEOs.

In 2007, 71% of outgoing Australian CEOs had been recruited internally and 59% of their replacements were also internal appointments. This is below the global benchmark, in which 79% of new recruits were internal in 2007 (a figure that has been largely steady since 1995).

Recent years have also seen an upturn in the proportion of first-time CEOs (most of them internal appointments) among all departing CEOs in Australia.

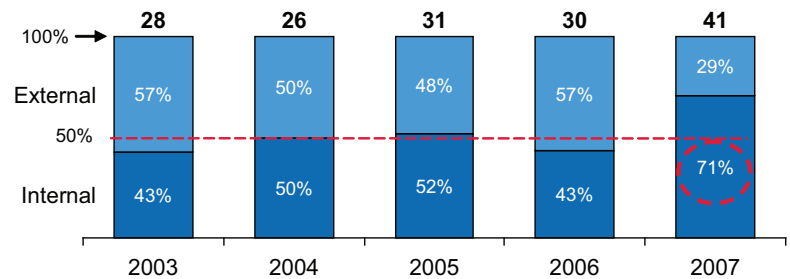
This tendency to replace inexperienced insiders with other inexperienced insiders,

combined with the high incidence of planned departures and improving shareholder legacy of departing CEOs generally, suggests Australian boards have become better prepared for CEO transitions, having embraced succession planning strategies.

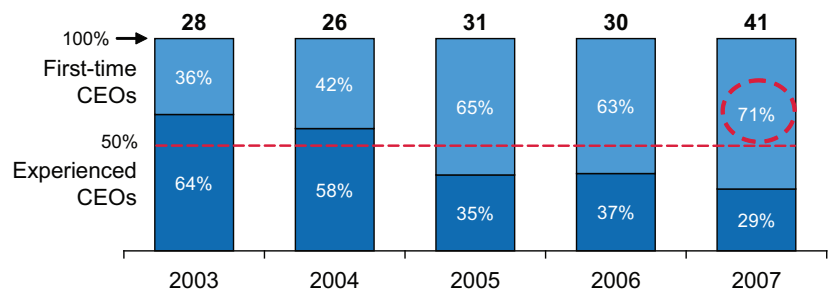
**Outsiders continue to outperform insiders**

Between 2000 and 2007, outsider CEOs in Australia have strongly outperformed insider CEOs on the key measure of average annual shareholder return. Outsiders delivered an average 16.6% return compared to the average 11.1% return of insiders. This is in line with the global trend, but contrasts somewhat

**Exhibit 14**  
**Departed CEOs: Internally vs. Externally sourced**  
 2003-2007



**Exhibit 15**  
**Departed CEOs: First-time vs. Experienced**  
 2003-2007



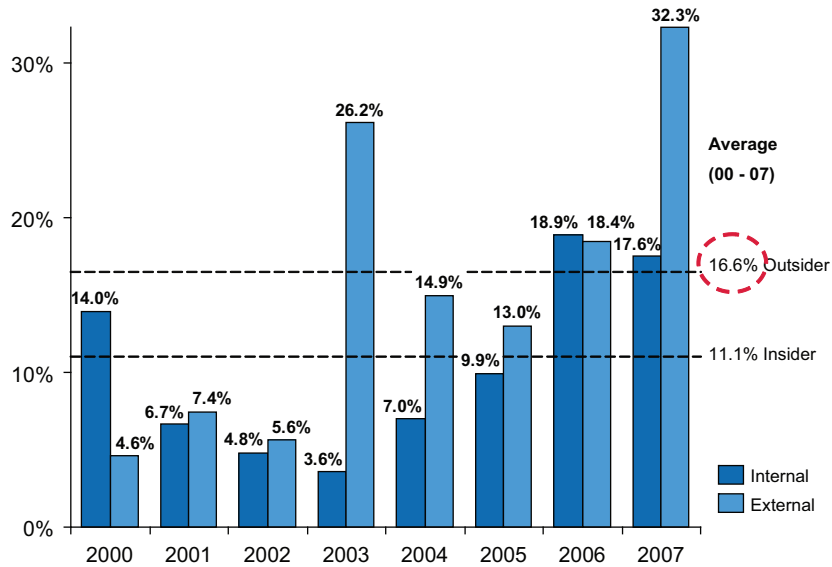
with trends observed in North America and Europe.

While it is tempting to conclude the preference of Australian boards toward selecting insiders has been misguided, it is more likely succession planning initiatives will take time to bear fruit in the form of insider CEO appointments generating improved shareholder returns.

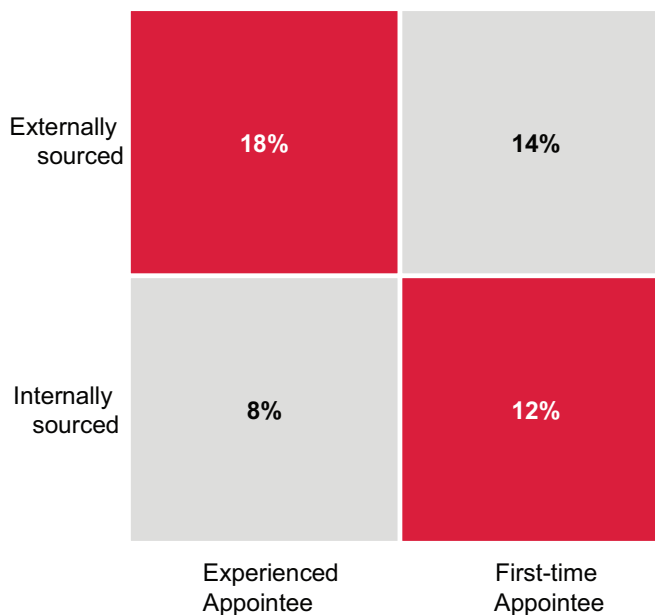
(It is worth noting that TSR data presented in Exhibit 16 differs from that presented in the 2006 study due to a change in methodology. In 2006, TSR was calculated by comparing returns before and after the date of CEO departure, whereas in 2007 the calculation was based on returns before and after the date on which the CEO departure was announced).

At this stage, strong evidence exists that outside candidates continue to deliver superior returns to those of their internal counterparts. Even where these external candidates are first-time appointees, the results are above internals. This suggests more rigour is put into the selection process when appointing an external candidate. However, boards remain more willing to take a potentially less skilled internal candidate, appreciating the value of their working knowledge of the business and its people, over breadth of previous experience.

**Exhibit 16**  
Annual Shareholder Returns Insider vs. Outsider in Australia  
2000-2007



**Exhibit 17**  
Average Annual Shareholder Returns of Departed CEOs  
2000-2007



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## KEY MESSAGES FOR AUSTRALIAN BOARDS, CEOs AND CHAIRMEN

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*“Outsider CEO’s in Australia have outperformed insider CEO’s on average shareholder return.”*

### **Window to act remains narrow**

The time available for Australian CEOs to execute their strategic agenda remains brief compared to their global counterparts. Since 2000, the average tenure of Australian CEOs has been 5.9 years, while their global counterparts last 8 years.

Given the size of the Australian market, the growth agenda of Australian CEOs often must incorporate offshore expansion and the associated risks of activity in Asian markets and cross-cultural commercial relationships. Recruitment of board members and CEOs with an Asia perspective and an appreciation of foreign cultures and business practices may therefore prove decisive in planning for future success.

### **Succession planning remains a high priority**

The trend of recent years towards appointing replacement CEOs from within, indicates boards have assimilated the importance of CEO succession planning. However, the relative underperformance of these internal candidates compared to their external counterparts suggests that Australian succession planning processes are yet to fully mature.

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This hypothesis is supported by a recent study from Chandler Macleod Consulting. In a survey of more than 300 business leaders and senior Human Resources practitioners, 49% of enterprises surveyed were found not to have succession planning procedures in place and of these, 54% were planning to implement one in the next 12 months. However, as little as 5% of Human Resources budgets were invested in succession planning and only 7% of respondents said their succession planning effort was ‘a formal and well established strategy with clear goals’.<sup>1</sup>

A clear succession plan and focus on internal development of candidates minimises the risk of a ‘rudderless’ period affecting corporate performance during the potentially long window required to recruit a suitable external candidate. It can also defray the significant cost of external recruitment, improve retention of senior executives, and ensure the new appointment hits the ground running.

### **Growing leaders for tomorrow**

Succession planning will not deliver results without a significant leadership development program underpinning it. Leaders for tomorrow require even greater breadth and depth of skills including the ability to manage significant (and potentially constant) change.

Organisations must look for ways to broaden insider candidates experience-base to maximise their

future effectiveness as CEOs.

“Leadership is a team sport” and as such CEO development and succession planning cannot be looked at in isolation of the surrounding top team of executives. Creating a balance of skills across the top team, leveraging strengths and off-setting weaknesses is far more effective than relying upon the success of a single individual.

### **Boards must strive to retain quality CEOs**

With more Australian CEOs electing to leave their roles in 2007 than at any time since 2000, and the performance of outgoing CEOs improving, the issue of CEO retention has come to the fore. High-performing CEOs not only bring a collective smile to the face of boards and shareholders, they also attract the attention of head-hunters. In the face-to-face interviews conducted by Booz & Company for the study, there was a common perception that local CEOs can take up positions overseas to further their careers, whereas in the U.S., for example, CEOs may already have reached their pinnacle.

Looking ahead, CEO retention must be considered hand-in-hand with succession planning. Failure to do so could see significant time and resources spent on developing CEOs internally, only to see them poached by rivals.

As a policy portfolio, CEO retention and succession planning become a tool for retaining

key executives. Rethinking the organisational structure is also critical for helping develop future business leaders. This should commence at recruitment, with an emphasis on long-term leadership potential. Boards must also give priority to talent development, including leadership training and CEO nurturing, as well as succession planning.

### **Methodology for the global study**

The study identified the world’s 2,500 largest public companies, defined by their market capitalisation on 1 January 2007. Market capitalisation rather than revenue was used because of the different ways financial companies recognise and account for revenue.

The Compusat/Global Vantage database of public companies provided a list of all publicly-traded companies on 31 December 2007.

To identify the companies among the top 2,500 that had experienced a CEO 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 the global Booz & Company research capability.

Each company that appeared to have experienced a CEO change was then investigated to confirm

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<sup>1</sup> “Succession planning still in its infancy”, Human Resources (Australia), November 23, 2007

that a change had occurred in 2007 and to confirm the key details of the outgoing executive. Information collected about the outgoing executive included: title upon succession, start and end dates of tenure as CEO, age, education, whether he or she was an insider or outsider immediately prior to the start of the tenure, whether he or she had served as a CEO elsewhere prior to this tenure, and the true reasons for succession.

Average growth rates (AGRs for total tenure, first half and second half) were calculated for two types of financial and shareholder information during the executive's tenure: net income and total shareholder return. Net income was provided by S&P (Custom Projects), quarterly data provided by North American-traded securities was also collected and annual data was provided for income data information for the relevant industry and region. Total shareholder returns (TSR)<sup>2</sup> data was provided by Thomson Financial Datastream. Regionally adjusted TSR AGRs 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**

For the Australian study Booz & Company identified the ASX 200 companies since 1998, a data set spanning 241 companies in 2007. We researched if and

when a CEO turnover event had taken place for all the ASX 200 companies since 1998.

To identify the companies among the ASX 200 that had experienced a CEO turnover event, annual reports and press searches for each individual company were used. Annual reports provided information on the CEOs for each of the financial years. Press searches were used to complement this data and to confirm the validity and reasoning for the turnover event. A variety of printed and electronic sources including Lexis Nexis, Australian Financial Review, Sydney Morning Herald, Business Review Weekly were also used. Additionally Factiva was used to identify announcements of retirements or new appointments of CEOs, Presidents and MDs for the ASX 200 companies in each year since 1998. TSR data was provided by Datastream and included market capitalisation growth, dividends and reinvestment of dividends.

Each company that appeared to have experienced a CEO change in 2007 was then examined to confirm that a change had occurred. Key details of the outgoing executive were collected to identify the underlying reason for the turnover event.

Consistent with the global study, CEO transition events were grouped into three categories: merger-based, in which a CEO's job was eliminated after an M&A transaction; regular transition including planned retirements, acceptance of a 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 incidents where there was a demonstrable performance shortfall but the departure was described as being for 'personal reasons' in press.

### **Australian companies surveyed**

The survey identified 40 Australian companies within the ASX 200 that had experienced CEO turnover events in 2007.

<sup>2</sup> The TSR calculation includes both share price appreciation and dividends

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