Sudden Death of a CEO: Are Companies Prepared When Lightning Strikes?

By David F. Larcker and Brian Tayan
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DEATH AND SUCCESSION PLANNING

When Jai Nagarkatti, CEO of Sigma-Aldrich, died of a heart attack in November 2010, his successor was announced the next day. Rakesh Sachdev, chief financial officer of the company, became CEO and at the same time was elected to the board of directors. By contrast, when Wendy's International CEO Gordon Teter died of a heart attack in December 1999, the company did not immediately name a successor. Instead, founder and director Dave Thomas was appointed to oversee a five-person management council that supervised the company's operations while the board searched for a permanent replacement. It was not until March 2000—three months later—that John Schuessler, head of U.S. operations and 25-year veteran, was promoted to CEO.

There is no greater test of the viability of a company's succession plan than the sudden death of its CEO. Approximately seven CEOs of publicly traded companies die each year. The most common causes of death are cancer, heart attack, and stroke. Less frequent, although still significant, are deaths due to airplane, automobile, and other accidents (see Exhibit 1).[1]

A company with a well-developed succession plan maintains a list of potential candidates that the board can turn to in case of an unexpected transition. Candidates are often internal executives who have been trained for higher levels of responsibility and whose skills, experiences, and leadership qualities match the strategic, operating, and cultural requirements of the company. In some cases, primary candidates are executives at other companies that the board has maintained contact with and whom the board is prepared to approach when a transition is required. If the circumstances are appropriate, a permanent successor is named without delay. In some cases (such as a company in turnaround or one that is in the process of building managerial talent), an emergency CEO is put in place until a permanent successor is identified.

A company without an operational succession plan does not have a set of viable candidates to turn to and often starts the evaluation process from scratch. In this case, the transition period can be lengthy, lasting several months or longer. Such delays can have a direct, negative impact on company performance. Behn, Dawley, Riley, and Yang (2006) demonstrate a negative relation between the length of the succession period and the future operating results of a company.[2] For this reason, many governance experts recommend that companies treat succession planning as a risk management exercise as much as a leadership development process.

A company might be able to reduce the uncertainty surrounding CEO succession by increasing disclosure around its succession plan. However, there is little evidence that shareholders find this disclosure valuable. According to Institutional Shareholder Services, shareholder sponsored proposals that would require companies to develop and disclose succession plans received only 27 percent support on average in 2011.[3] This suggests that, while investors expect companies to develop succession plans, disclosure might not be informative of whether these plans are viable.[4]

DEATH AND GOVERNANCE QUALITY

The sudden death of a CEO also provides an (unfortunate) opportunity to provide insight into the general quality of the firm's governance. When a

CEO passes away, two distinct events occur. The first is the announcement of the death itself. The second is the announcement of the successor.[5] The price of a company tends to go down following news of a CEO's death if the CEO is seen as a strong leader or vital to the company, and it tends to go up if the CEO is seen as entrenched, a poor leader, or inhibiting a sale of the company. In this way, a positive stock price reaction implies the presence of poor corporate governance, while a negative stock price reaction implies good governance.[6] The case is reversed for the announcement of the successor. A positive stock price reaction suggests that shareholders believe the board of directors has made the right hiring decision for the company, while a negative reaction suggests that shareholders disapprove of the board's selection or that the hiring decision makes it less likely that the company will be sold (see Exhibit 2).[7]

For example, when Gerald Pencer, CEO of Cott Corporation, died of cancer in 1998, the stock price increased 8.1 percent. Pencer and his family owned a 29 percent stake in Cott, and his death was seen as a catalyst that would accelerate changes or possibly lead to a sale of the company. When former Campbell Soup executive Frank Weise was named CEO of Cott five months later, the stock rose 6.5 percent. The appointment of Weise, announced concurrently with a $110 million investment from private-equity firm Thomas H. Lee, was viewed as a commitment to boost growth, with the potential for a sale of the company down the road.[8]

WHY THIS MATTERS

1. It is very difficult for shareholders to gain detailed information about CEO succession planning among the companies they have invested in.[9] Although CEO deaths are rare, the sudden death of a CEO can provide insight into the quality of succession planning and governance of a company. Whereas some companies are able to appoint a successor immediately, others take weeks or months to do so. Boards should do the "reality check" on whether they truly have an operational succession plan in place.
2. If firms have "good" CEOs, you would expect the returns to an unexpected CEO death to be negative. What should board members do if the return following the death of their CEO is *positive*?
3. Most of the successor CEOs in Exhibit 2 are internal promotions. Does this mean that the best candidates are internal or these companies could not find external CEOs in a timely manner (i.e., this was lacking in the succession plan)? Notice that the external searches take considerably longer (four to six months) than internal searches.
4. Should the board revise its succession plan if its CEO engages in risky hobbies (e.g., being a pilot or racing motorcycles) or risky habits (e.g., smoking and excessive drinking)? Should disclosure to shareholders be different in this situation? ■

[1] Statistic includes senior leaders with titles CEO, chairman, president or a combination of these between 1978 and 2000. See Borokhovich, Brunarski, Donahue, and Harman, "The Importance of Board Quality in the Event of a CEO Death," *The Financial Review* (2006).

[2] Bruce K. Behn, David D. Dawley, Richard Riley, and Ya-wen Yang, "Deaths of CEOs: Are Delays in Naming Successors and Insider/Outsider Succession Associated with Subsequent Firm Performance?" *Journal of Managerial Issues* (Spring 2006).

[3] Institutional Shareholder Services, 2011 U.S. Proxy Season Scorecard.

[4] See: David F. Larcker and Brian Tayan, "CEO Health Disclosure at Apple: A Public or Private Matter?" CGRP-12 (Jan. 24, 2011).

[5] In some cases these are concurrent. When news of the death and news of the appointment occur on the same trading day, it is difficult to determine which news is more salient in determining the market's reaction.

[6] Johnson, Magee, Nagaran, and Newman (1985) find evidence of this. While they observe no uniform pattern across a sample of sudden deaths, they do find highly divergent reactions within their sample. This suggests that the market's assessment of governance quality is specific to the company and its CEO. Salas (2007) finds similar results. See: W. Bruce Johnson, Robert P. Magee, Nandu J. Nagarajan, and Harry A. Newman, "An Analysis of the Stock-Price Reaction to Sudden Executive Deaths—Implications for the Managerial Labor Market," *Journal of Accounting & Economics* (1985); Jesus M. Salas, "Entrenchment, Governance, and the Stock Price Reaction to Sudden Executive Deaths," *Journal of Banking & Finance* (2010).

[7] Worrell and Davidson (1987) find that the stock market reaction to the announcement of an internal successor is generally positive while there is no statistically significant reaction to the announcement of an external successor. See Dan L. Worrell and Wallace N. Davidson III, "The Effect of CEO Succession on Stockholder Wealth in Large Firms Following the Death of the Predecessor," *Journal of Management* (1987).

[8] Cathleen Egan, "Cott's New Chief Eager to Turn around Soft-Drink Company's Fortune," *Dow Jones Online News*, Jun. 12, 1998.

[9] Survey data suggests that many firms do not have adequate succession planning. See: Heidrick & Struggles and the Rock Center for Corporate Governance at Stanford University, "2010 Survey on CEO Succession Planning," Jun. 2010.

David Larcker is the Morgan Stanley Director of the Center for Leadership Development and Research at the Stanford Graduate School of Business and senior faculty member at the Rock Center for Corporate Governance at Stanford University. Brian Tayan is a researcher with Stanford's Center for Leadership Development and Research. They are coauthors of the books *A Real Look at Real World Corporate Governance* and *Corporate Governance Matters.*
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EXHIBIT 1 — CAUSES OF CEO DEATH (1978-2000)

Cause of Death	Number of Deaths
Heart attack/heart failure	39
Automobile accident, airplane accident, drowning, lightning, or fire	14
Unexpected sudden natural causes (including stroke or brain aneurysm)	28
Brief illness or pneumonia	16
Cancer or other tumor	30
Long illness (heart disease, medical leave cited)	12
Following surgery for unreported illness	2
Unknown or undisclosed cause	20
Total	161

Source: Borokhovich, Brunarski, Donahue, and Harman. The Importance of Board Quality in the Event of a CEO Death. *The Financial Review* 41 (2006).

EXHIBIT 2 — CEO DEATHS: SUCCESSION TIMELINE AND STOCK MARK REACTION

Company	CEO	Date of Death	Age	Tenure as CEO	Cause	Stock Price Change on Death	Days until Successor	Successor	Stock Price Change on Successor
Micron Technologies	Steven Appleton	Feb. 3 2012	51	12	Plane crash	-2.8%	2 days	Internal	-2.8%*
Sigma-Aldrich	Jai Nagarkatti	Nov. 13 2010	63	4	Heart attack	-1.0%	1 day	Internal	-1.0%*
McDonald's	Jim Cantalupo	Apr. 19 2004	60	1	Heart attack	-2.6%	0 days	Internal	-2.6%*
Dana Corp.	Joseph Magliochetti	Sep. 22 2003	61	4	Pancreatitis	1.6%	135 days	External	-0.2%
Triangle Pharmaceutical	David Barry	Jan. 28 2002	58	7	Heart attack	1.0%	189 days	External	0.7%
Atlas Air	Michael Chowdry	Jan. 24 2001	45	9	Plane crash	-4.9%	1 day	Internal	-4.9%*
Park Place Entertainment	Arthur Goldberg	Oct. 19 2000	58	10	Bone marrow failure	-6.4%	4 days	Internal	0.9%
Herbalife	Mark Hughes	May 21 2000	44	20	Overdose	-12.0%	16 days	Internal	-3.2%
Wendy's	Gordon Teter	Dec. 18 1999	58	5	Heart attack	0.3%	89 days	Internal	-7.8%
Cott Corp.	Gerald Pencer	Feb. 3 1998	52	9	Cancer	8.1%	129 days	External	6.5%
Texas Instruments	Jerry Junkins	May. 29 1996	58	11	Heart attack	-1.8%	26 days	Internal	-0.2%
McCormick & Co.	Bailey Thomas	Jul. 14 1994	63	2	Heart attack	-3.7%	5 days	Internal	1.0%

* Indicates that the announcement of the successor occurred on the first trading day following the death of the CEO. In these cases, the stock market change reflects the combined reaction to the announcements of the CEO's death and the appointment of the successor.

Source: Research by the authors. Share price information from Center for Research Security Prices (University of Chicago) and Yahoo! Finance.