Separation Anxiety: The Impact of CEO Divorce on Shareholders

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INTRODUCTION

When Rupert Murdoch, Chairman and CEO of News Corp, announced that he and his wife Wendi of 14 years were filing for divorce, shares of News Corp traded 1.4 percent higher. A prenuptial agreement meant that Wendi would not have access to Murdoch's 38 percent economic stake in the company, nor would the divorce threaten the planned spinoff of the company's newspaper assets into a separately traded corporation. According to a spokesperson, the divorce would have "zero impact on the company."[1]

By contrast, when news leaked that Harold Hamm, Chairman and CEO of Continental Resources, was getting divorced from wife Sue Ann of 25 years, shares of the company fell 2.9 percent. The Hamms did not sign a premarital contract, making Harold's 68 percent ownership stake (worth $11.2 billion) subject to equitable distribution under Oklahoma family law. Despite a company press release that the divorce "has not and is not anticipated to have any impact or effect on the Company's business or operations," not everyone was convinced.[2] According to RBC Capital, the divorce "opens up the possibility that Hamm could have to sell a significant amount of his stock to pay a divorce settlement, or he could be forced to hand some of his stock over to his ex-wife. We believe both of these would result in a substantial overhang on the stock, and could result in Hamm losing majority control."[3]

The previous examples suggest that shareholders should pay attention to matters involving the personal lives of CEOs and take this information into account when making investment decisions.

IMPACT OF DIVORCE

There are at least three potential ways in which a CEO divorce might impact a corporation and its shareholders. The first is loss of control or influence. A CEO with a significant ownership stake in a company might be forced to sell or transfer a portion of this stake to satisfy the terms of a divorce settlement. This can reduce the influence that he or she has over the organization and impact decisions regarding corporate strategy, asset ownership, and board composition. Shareholder reaction to loss of control will vary, depending on the view that investors have of CEO performance and governance quality. If they view performance and governance quality favorably, they will react negatively to the news; if they view management as entrenched or a poor steward of assets, they will react positively. Shareholder reaction will also depend in part on what happens to divested shares, including whether they are transferred to the spouse, sold in a block to a third-party, or dispersed in the general market. Each of these can shape the future governance of a firm.[4]

Second, divorce can affect the productivity, concentration, and energy levels of the CEO. According to Wheatley, Vogt, and Murrell (1991), 37 percent of companies report that employee divorce negatively impacts firm productivity.[5] In the extreme, the distraction of divorce can lead to premature retirement. For example, a recent divorce and new relationship were speculated to be among the reasons why A.G. Lafley stepped down as Chairman and CEO of Procter and Gamble in 2009. Lafley, who filed for divorce in 2007, had been "pushing to leave his CEO post for a couple of years" despite a previous pledge to remain through 2010.[6]

"It was done rather abruptly," according to one analyst. "We had been saying A.G. had committed to deliver the decade, and the decade was one more year."[7] Although we are unaware of rigorous research on the relation between divorce and CEO retirement, small samples of data suggest an elevation in CEO retirement rates following divorce. Among 24 CEOs who got divorced between 2009 and 2012, seven (29 percent) stepped down within two years of the settlement (see Exhibit 1).[8]

Third, divorce can influence a CEO's attitude toward risk. The board of directors designs a compensation program and imposes ownership guidelines on executives to ensure they have incentive to meet company objectives. A sudden change in wealth—through loss of equity in the company they are running or other investments outside the firm—can alter an executive's risk appetite, and therefore affect decision making.

For example, a CEO who funds a divorce settlement by divesting primarily personal assets outside of the firm but retaining a large equity position in the firm might become more *risk-averse* to protect the value of a more concentrated (less diversified) portfolio. A CEO in this situation might reject promising but risky investments because his or her personal financial exposure to these decisions has increased relative to total wealth. This will reduce the volatility of the stock price but also lower potential returns for shareholders. While the firm will be less risky as a whole, the company will also miss out on promising investments with positive expected returns that could increase shareholder over time.

Conversely, a CEO might react to a sudden loss of wealth by becoming more *risk-seeking* as he or she attempts to "win back" personal wealth that was lost. A CEO in this situation might approve higher-risk investments to boost the value of his or her remaining equity holdings following divorce. This will increase the volatility of the stock price, but only increase shareholder value if the investments have positive expected value. The board might respond to a change in the executive's risk appetite by awarding larger cash or equity compensation to "restore" incentives to what they were prior to divorce.

There is modest evidence that this occurs. Neyland (2012) finds that total CEO compensation increases following divorce. He concludes that "boards react to changes in CEOs' outside wealth and risk incentives" by increasing compensation and that "the cost of compensation increases comes at the expense of the shareholders."[9] A separate sample of divorced CEOs suggests some level of compensation increase following divorce, although the results are irregular (see Exhibit 2).

WHY THIS MATTERS

1. Divorce can impact the control, productivity, and economic incentives of an executive—and therefore corporate value. Should shareholders and boards be concerned when a CEO and spouse separate?
2. Rigorous research demonstrates a relation between the size and mix of a CEO's equity exposure and risk taking.[10] Should the board "make whole" the CEO in order to get incentives back to where they originally intended? Would this decision be a "cost" to shareholders because it represents supplemental pay that could have been used to fund profitable investments, or a "benefit" because it realigns incentives and risk taking?
3. Companies do not always disclose when a CEO gets divorced. Reports only come out much later when shares are sold to satisfy the terms of the settlement. Is divorce a private matter, or should companies disclose this information to shareholders? If so, how detailed should this disclosure be? ■

[1] "People in the News," The Press Association (Jun. 14, 2013).
[2] Continental Resources Press Release, "Continental Resources Confirms CEO Divorce Pending," (Mar. 21, 2013).
[3] Leo Mariani, "CLR—CEO Harold Hamm Confirms Pending Divorce; Slight Negative for the Stock," RBC Capital Markets (Mar. 21, 2013).
[4] For additional background of this issue, see: Clifford Holderness, "A Survey of Blockholders and Corporate Control," *Economic Policy Review*, Federal Reserve Bank of New York (2003).
[5] Walter J. Wheatley, Judith F. Vogt, and Kenneth L. Murrell, "The Concern of Divorce in Organizations: A Survey of Human Resource Managers," *Journal of Divorce & Remarriage* (1991).
[6] Ellen Byron, "P&G Chooses a New CEO As it Adapts to Era of Thrift," *The Wall Street Journal* (Jun. 9, 2009).
[7] Jennifer Reingold, "The $79 Billion Handoff," *Fortune* (Dec. 7, 2009).
[8] These statistics include instances where the CEO left after their

firm was acquired. Without disclosure, it is always difficult to assess the degree to which divorce contributed to resignation decisions. Source: Research by the authors. Data from the Securities and Exchange Commission.

[9] Jordan Neyland, "Wealth Shocks and Executive Compensation: Evidence from CEO Divorce," (Sep. 3, 2012). Available at SSRN: http://ssrn.com/abstract=2140668.

[10] See: David F. Larcker and Brian Tayan, "Sensitivity of CEO Wealth to Stock Price: A New Tool for Assessing Pay for Performance," Stanford Closer Look Series, CGRP-10 (2010) and Christopher Armstrong, David Larcker, Gaizka Ormazabal, and Daniel Taylor, "The Relation Between Equity Incentives and Misreporting: The Role of Risk-Taking Incentives," *Journal of Financial Economics*, (2013).

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EXHIBIT 1 — DIVORCE AND CEO TENURE

Company	CEO	Year Divorced	Resignation after Divorce (Years)	Tenure at Resignation (Years)
Corporate Office Properties Trust	Randall Griffin	2010	1.5	7
KBW	John Duffy	2012	-0.75	12
Medicis Pharmaceutical	Jonah Shacknai	2011	1.7	25
Microtune	James Fontaine	2010	0.8	7
Orion Energy Systems	Neal Verfuerth	2012	0.1	7
Pacific Biosciences	Hugh Martin	2012	-0.1	8
Symantec	Enrique Salem	2011	1.4	3

Note: Year of divorce estimated based on first Form 4 disclosure of equity sale. A negative (-) sign indicates that the CEO resigned before the estimated divorce date. For three firms (KBW, Medicis, and Microtune), the CEO left following an acquisition.

Source: Research by the authors. Date from Securities and Exchange Commission.

EXHIBIT 2 — DIVORCE AND ANNUAL COMPENSATION

Company	CEO	Year Divorced	Total Pay Year -1	Total Pay Year Divorced	Total Pay Year +1	Increase After Divorce	Industry Average
Bally Technologies	Richard Haddrill	2010	$3,010,339	$2,654,873	$6,477,764	144%	-4%
Buffalo Wild Wings	Sally Smith	2011	$1,969,990	$2,115,112	$3,921,967	85%	n/a
Corporate Office Properties Trust	Randall Griffin	2010	$4,161,502	$6,053,010	$3,041,611	-50%	15%
Credit Acceptance Corp	Brett Roberts	2010	$805,385	$807,350	$982,350	21%	27%
Forbes Energy Services	John Crisp	2011	$825,264	$1,187,270	$1,234,800	4%	n/a
Health Care REIT	George Chapman	2011	$6,510,825	$7,400,176	$12,321,589	67%	n/a
IMAX	Richard Gelfond	2009	n/a	$4,933,322	$13,074,747	165%	26%
Symantec	Enrique Salem	2011	$8,509,683	$9,388,462	$10,844,396	15%	n/a
Torchmark	Mark McAndrew	2010	$2,836,298	$6,274,121	$8,068,185	29%	-11%
Warren Resources	Norman Swanton	2010	$609,812	$1,975,982	$1,874,507	-5%	3%

Note: Year of divorce estimated based on first Form 4 disclosure of equity sale. Compensation includes total compensation as reported in the annual proxy. “N/A” under Total Pay indicates that the executive did not serve as CEO during this year; “n/a” under Industry Average indicates that industry compensation data for the year in question is not yet available to the researchers.

Source: Research by the authors. Date from Securities and Exchange Commission.