FTI Consulting Study Shows CEO Transitions Are a Risky Business When It Comes to Shareholder Value

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Strategic Communications Practice Study Challenges Perceptions of CEO Transitions and the Risk to Enterprise Value

WEST PALM BEACH, Fla., Oct. 18, 2011 /PRNewswire via COMTEX/ -- Investors tend to be sellers rather than buyers immediately after a change in CEOs, according to a new study released today by the Strategic Communications practice of FTI Consulting (NYSE: FCN), the global business advisory firm dedicated to helping organizations protect and enhance their enterprise value. However, new CEOs have a honeymoon period of six months after their announced arrival in which to sell the Street on their vision and strategy, as well as the ability to effectively manage shareholder expectations. Those CEOs who satisfy on these dimensions will recoup and enhance shareholder value for their companies.

The study, which draws from extensive primary research of portfolio managers and analysts, as well as a global multi-year analysis of stock price changes surrounding CEO transitions, explores the inherent risk of CEO transitions and challenges the traditional wisdom surrounding stock volatility and the threat to enterprise value around such critical business events.

The study also confirms the significant role that the CEO reputation plays in the financial community's decision to buy, sell or hold a company's shares.

"When a company has a change in leadership of its chief executive, a primary concern of the board of directors is the reaction of the stock market at the time of the event," said Ed Reilly, Global Chief Executive Officer of the Strategic Communications practice at FTI Consulting. "What companies tend to overlook is that the real inflection point and the measure of a successful transition comes after six months. Thus, new CEOs must align their organizations to respond to change by setting the vision and strategy, establishing the appropriate expectations across stakeholder groups, and then engaging with stakeholders through new and diverse communications channels."

CEO Transitions More Often Push Investors to Sell

The findings, available for download at http://www.ceotransitionstudy.com/, show that when the leadership of a company changes, investors feel compelled to re-evaluate their investment position, and, more often than not, the result is that investors decide to sell their stock rather than buy. Specifically, the study found that:

- CEO reputation influences almost one-third (32 percent) of the investment decision.
- Thirty-nine percent of the investors surveyed indicate they are likely to sell a stock based solely on the reputation of the CEO, while only 15 percent say they are likely to buy a stock under similar conditions.
- In terms of factors impacting an organization's reputation, CEO reputation (25 percent) is nearly as important as the historical reputation of a company (26 percent) to investors and more important than the brand equity of the company's products or services (21 percent).

New CEOs Must Articulate Credentials to Win Over Investors

An interesting paradox unearthed by the study is that, although a CEO's prior track record of execution is the most heavily weighted characteristic for influencing the investment community's perception (63 percent), 80 percent of new CEOs have no prior CEO experience. Therefore, there often is minimal publicly accessible independent information of past performance available, thus increasing the risk as perceived by investors. As a result, 40 percent of investors say they turn to sell-side analysts to get information, while 27 percent turn to the media. Investors say they would prefer to rely on primary sources such as customers and partners (78 percent), as well as the CEO's former colleagues (69 percent) if such resources were available.

In addition, a CEO's leadership style and charisma, ironically, are the least important factors to investors, as compared with his or her grasp of the company's challenges, knowledge of the industry, vision and operational focus. Thus, it is crucial for a company to effectively communicate as much substantive information as possible to the investment community that will support the perception of the new CEO as a person with an industry-relevant history of execution and a strong following among former colleagues, partners and customers.

The End of the Honeymoon Period Is More Risky than the Beginning

Contrary to popular belief, the study found that while the circumstances of the CEO's transition (such as strategic transformation, voluntary or forced resignation, succession, fraud or crisis) may change the degree of volatility of the stock around the time of the announcement, the most significant period comes in the months that follow the announcement. The study found that six months after taking the post, investors reward or penalize new CEOs based on their articulation of corporate strategy (68 percent), setting of stakeholder expectations (66 percent) and talent management (46 percent). So while the initial reaction to the announcement of a new CEO often may be negative -- notwithstanding the circumstances of his or her ascension to that post -- this negative reaction can be reversed over time. Meanwhile, investors should be prepared for high volatility until the new CEO is better established and the vision and strategy fully articulated.

The study's findings have significant implications for boards of directors, specifically with regard to succession planning to minimize the initial negative reaction and the resultant period of volatility when an abrupt change in executive leadership takes place. However, it must be accompanied with and informed by a robust due diligence on all CEO candidates. In addition, having a deep knowledge of stakeholder opinions on the company, its strategy and competitive position can help to align board decisions with stakeholder expectations, permissions and needs. This can be particularly helpful in addressing the ongoing risk inherent in transitions involving fraud, regulatory investigations, strategic transformations, bankruptcies and restructuring. Boards also should consider that while many companies work to shape media reaction to the event of the CEO transition, the media is the least influential in shaping investors' perceptions of a new CEO and is only one of the many crucial stakeholder groups to reach.

For more information, methodology and access to the complete findings and white paper entitled Communicating Critical Events: CEO Transitions and the Risk to Enterprise Value, please visit http://www.ceotransitionstudy.com/.

About the FTI Consulting CEO Transition Study

This study is the first edition of the global series Communicating Critical Events: CEO Transitions and the Risk to Enterprise Value, conducted by the Strategic Communications practice of FTI Consulting. To better understand and quantify the value-at-risk during leadership changes at large-capitalization companies, FTI Consulting studied 263 companies across 37 countries. The selected CEO transitions were analyzed on the basis of alpha, net stock performance was examined relative to a comparable index (i.e., a positive alpha indicates the stock outperformed its benchmark index), and the relevant indices were determined by the country of domicile and local exchange on which the shares traded (e.g., S&P 500 Index, FTSE 100 Index, Nikkei 225 Index, German DAX Index, Paris CAC 40 Index). Each transition was further classified based on a number of characteristics to fully encapsulate the details of the situation, including background of the incoming CEO and circumstances that led to the transition. FTI Consulting also solicited feedback from 358 portfolio managers and analysts to better understand the extent to which CEO reputation, in general, and leadership changes, in particular, impact investment decisions and, therefore, enterprise value.

About the Strategic Communications Practice of FTI Consulting

The Strategic Communications practice of FTI Consulting, formerly known as FD, is one of the world's most highly regarded communications consultancies. With more than 20 years of experience advising management teams in critical situations, the Strategic Communications practice supports clients in protecting and enhancing their reputation in the capital markets, society and the political environment. Services of the Strategic Communications practice are financial communications, corporate communications and public affairs, with specialty offerings that include strategy consulting, research, creative engagement, crisis and issues management, and change communications. The Strategic Communications practice of FTI Consulting is an established market leader in M&A communications and has been for many years.

About FTI Consulting

FTI Consulting, Inc. is a global business advisory firm dedicated to helping organizations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 3,700 employees located in 22 countries, FTI Consulting professionals work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring. The company generated $1.4 billion in revenues during fiscal year 2010. More information can be found at http://www.fticonsulting.com/.

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