When the CEO Becomes Only the Chairman

Introduction

There is a time in many organizations when the Chairman and Chief Executive Officer (CEO) decides that the company needs new CEO, and the organization needs the continuity, leadership and capabilities of the existing Chairman. This paper will examine the key factors in separating the roles of Chairman and CEO, with an emphasis that the individual will retain the Chairman of the company role and transition the CEO to another individual.

Prevalence of the CEO becoming Board Chair

The first question is to determine how often companies face this situation. If it is highly prevalent, then there will be clear policies and practices documented by organizations. Two sources of information were found on this question; one was a survey of Board compensation by Frederick W. Cook & Co., (2012) and one done by the Conference Board (2010). In the Cook study, only 8% of companies have a Board Chair that was the CEO of the company. This study tends to include very large companies, including the Fortune 200. In the Conference Board study, the data showed that 36% of Chairs were once the CEO. The Conference Board study covers 279 companies, and reflects a broader range of the market in terms of company size/revenues. Therefore, the finding is that this practice is more common in smaller companies, where the CEO (former) plays a critical role in the ongoing success, performance and continuity of the organization.

Issues Faced by the Transition from CEO to Chairman

The Conference Board report provides a good summary of the issues that emerge from this change in leadership. Their findings were also articulated in a number of articles, forums, and papers on executive succession. The most important issue appears to be the level of activity that the former CEO (now Board Chair) plays in the leadership and decision making of the company. The former CEO is most effective when he (or she) addresses Board issues only and serves as a facilitator of communication between the Board and executive management. The former CEO should resist getting involved in budgeting, business planning, organization restructuring, leadership staffing, and management communication matters. The former CEO may continue to be an external voice of the company with critical customers, investors, and suppliers, but this should be part of one’s role on the Board and not as a spokesman for management. This should also be transitioned to the new CEO over time. The former CEO is often highly effective in making sure strategic decisions are well conceived, long-term investments and capital support the future needs of the company, and the Board functions as a strong team. Therefore, the former CEO should limit one's time where he is accessible to others in the organization, and instead be an advisor or coach to the new CEO. These findings are important because they set the "context" for compensation, perquisites and other activities for the Board Chair.

Compensation for the Chairman of the Board

When the CEO was both the CEO and Chairman of the Board, he or she did not receive compensation for this role on the Board. But now, since he or she will no longer be an employee of the company, there is a need to determine an appropriate level of compensation for this role. When examining Board Leadership Compensation practices, we find an interesting pattern. There are two roles that lead the Board, one is the Non-Employee Board Chair and the other is a Lead Director (in this case the CEO in these companies is still the Chairman of the Board). The compensation levels between the two roles are quite different. This data is shown below:

	Board Chair		Board Member		Ratio Chair to Member	
Conference Board Report	**Retainer**	**Total Compensation**	**Retainer**	**Total Compensation**	**Retainer**	**Total Compensation**
Non-EE Chairman		$ 126,750	$ 30,000	$ 85,000		1.5
Lead Director		$ 105,725				1.2

This data shows that there is a distinct difference between a Non-Employee Chair and a Lead Director. Further, the Chairman is usually paid in relation to other members of the Board rather than the previous role as CEO. Further, a study by NACD (National Association of Corporate Directors) on Board Compensation (2012) provides data that shows Non-Employee Chairs receive compensation that is 1.5x (for companies with revenues between $50M - $500M) and 1.9x (for Top 200 companies) higher than the average board member; and the compensation of Lead Directors is 1.1x that of the average board member. While all Board Chairs are actively engaged in their companies, the upper range would be used when a Board Chair is "more" actively engaged in the interests of the company. Much of the work of the Chairman is done prior or following the actual meeting of the Board; hence, retainers are often a preferred vehicle for compensation. It would be appropriate and may be advantageous to pay a retainer only for the responsibilities as Board Chair.

Benefits and Perquisites for the Chairman of the Board

Few benefits are provided to members of the Board of most companies. If there are benefits (excluding Director & Officer liability insurance, reimbursement for travel expenses to Board meetings, etc.) they usually include matching charitable gifts, additional group life and/or travel insurance programs, and the opportunity to defer a portion of fees into deferred compensation programs. Since the CEO will no longer be an employee of the company, he will not be eligible for the company's health, life, disability, retirement and other employee benefit programs. In addition, a few companies report the provision of perquisites to their Chairs, such as:

- automobile allowance,
- travel related perquisites (e.g., Travel Clubs, First Class travel, Spouse travel)
- payment for cell phone cost,
- club membership,
- home office expenses or an office within the company's facilities.

These special benefits or perquisites are awarded to the Chairman when he has frequent use for business purposes. Often Chairs are actively engaged in building and/or retaining relationships with key customers, investors and/or suppliers, and must travel to meetings on company business. Consequently, auto, cell phone, and club memberships are an additional "cost of doing business." While the prevalence and value of these additional elements of compensation are not reported in public documents or compensation surveys, they are used by some companies based on the relationship and role the Chairman will have with the organization. These tend to be provided when a Chairman operates in an active leadership role with the company.

Consulting Services for the Board Chair

Some companies need the departing CEO as a consultant to the company for between one to three years (some longer). The primary purpose of these consulting assignments is to be available to provide advice and counsel to the new CEO or the Board. This role serves in an advisory capacity, and may be of invaluable service to the company. It has also been used to provide payments similar to a "severance" or to provide special compensation to the former CEO; in some organizations these payments have been severely criticized by shareholders and the media. So, there is a risk associated with payments when the former CEO is not performing meaningful work. In some cases cited in our research, when there is a major initiative that requires the unique expertise and knowledge of the former CEO, such as with an acquisition, merger, new product development, new market expansion, etc., the CEO serving as a consultant to the company can make very meaningful contributions to the success of the initiative. In these cases, where there are clear deliverables and meaningful work, a consulting agreement is an excellent use of the individual's experience and expenditure of the company.

In terms of compensation for a former CEO, the payment is defined by the “market value” of such expertise. The compensation is usually paid in the form of a retainer rather than an hourly or project based consulting agreement. The retainer may last from 3 months to 1 year, and seldom exceeds one year. The agreement may be renewed by the Board over time. The amount is discretionary, but in some cases it is between 40% and 60% of the CEO’s annual salary divided over the months he or she is serving as a consultant.

To convert a Chairman’s salary into a consulting fee, we use an assumption of the work availability of approximately 150 days per year (this is the number of days a senior level consultant usually bills clients). Using 40% of an illustrative salary of $750,000, a consulting fee would be $2,000 per day or at 60% of salary, the consulting fee would be approximately $3,000 per day.

There is little evidence where a former CEO serves in a consulting role while also serving as the Chairman of the Board. There are just too many challenges to identify when one is serving as the Chair or a consultant, and role conflicts can become a problem within the organization.

Summary of Findings and Guiding Principles
To summarize the findings we can conclude the following:

1. Retaining a former CEO on the Board often has positive benefits on the continuity and performance of the company as long as the former CEO continues to support the new CEO in exercising his role and responsibilities.

2. There is little documented evidence on the impact when an individual relinquishes the CEO role and remains only as the Chairman of the Board. The evidence shows that this works effectively in providing for an orderly transition of governance as long as the new “Non-employee Chairman” focuses on Board matters and leaves running the company to the next generation of leaders.

3. Board leadership comes in three forms – a Chairman and CEO (employed by the company), a Chairman (non-employee) and a Lead Director (non-employee where there currently is an employed Chairman and CEO). Compensation between the independent Chairman and Lead Director vary dramatically. The higher paid Chairman position has major governance responsibilities for the corporation and is compensated at 1.5x (50% higher) to 2.0x (100% higher) in total compensation compared to other members of the Board. The Lead Director is paid 1.2x (20% higher) to 1.4x (40% higher) the pay of other directors.

4. Benefit and perquisite programs are rare for Board members. However, if the Chairman (former CEO) is actively engaged in business activities for the company, then certain benefits are provided such as a car allowance, cell phone costs, club memberships, travel perquisites, etc.

5. Former CEO's become consultants to their companies for a variety of reasons. These payments are more legitimate when there are a number of specific initiatives where the individual's experience and specialized know-how or relationships provide clear benefits to the company. It is very rare for a Chairman to also have a consulting relationship with the company.

by
Thomas B. Wilson
Wilson Group, Inc.
twilson@wilsongroup.com
www.WilsonGroup.com