SUCCESSION AND THE C-SUITE

Used properly, retention grants for senior executives can be an effective transition tactic.

IT'S NO SECRET that leadership changeovers are where boards are most likely to have a critical, lasting impact on a company. While succession planning tends to focus on identifying and onboarding the new CEO, maintaining a stable, engaged and high-functioning team during the leadership handoff is just as crucial to a smooth, successful transfer of power. The surprise, unwanted exit of a key executive early in a new leader's tenure can disrupt what is, by nature, a precarious situation.

Yet, all too often, that's exactly what happens, as senior executives passed over for the top job or simply unsettled by the change, leave to seek other opportunities. Offering retention grants to leadership team executives, or cash and equity awards with delayed vesting, is one way that boards look to limit post-succession turnover in the C-Suite. Generally, they are effective—at least for a while, according to a recent study of 65 large-cap companies experiencing CEO turnover from 2010 to 2016 by FW Cook.

"The study confirmed the conventional wisdom that when you're giving people special equity grants, they're going to stick around longer," says Marco Pizzitola, a consultant at FW Cook. "But while retention grants do keep people around in this particular situation, they are very much a short-term solution, and the implications of that are important."

A TEMPORARY TIE

Among the companies in the FW Cook study, nearly 40 percent made succession-related retention grants to non-CEO named executive officers (NEOs). Of the executives receiving grants, just 8 percent departed within the first year. The number was almost double (15 percent) for those not receiving retention grants. While this difference was far less pronounced in the second year—10 percent and 13 percent, respectively—the disparity suggests post-succession retention grants are most effective at adding "glue to the seat" in the first two years after CEO turnover.

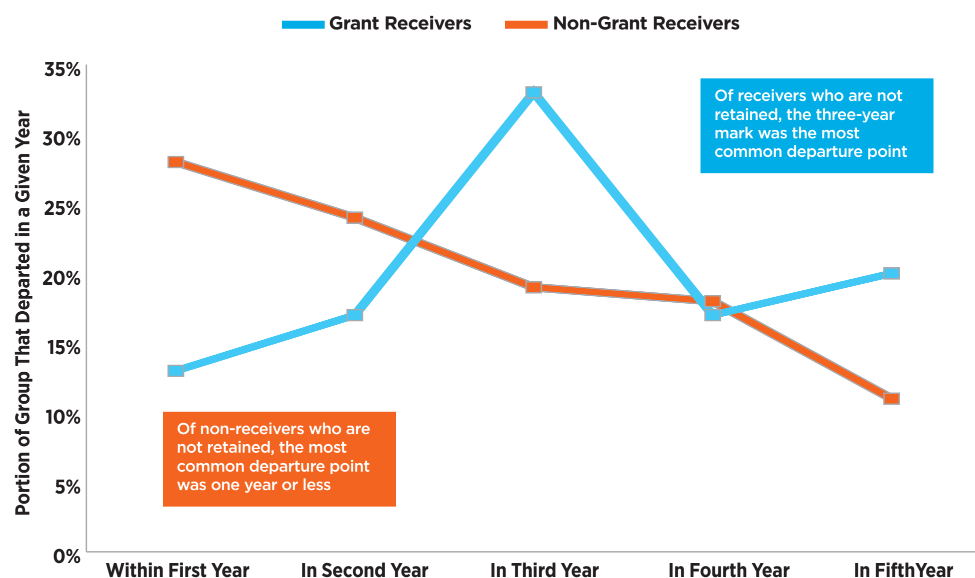
For boards, the message is clear: They have bought time, not long-term loyalty. "The takeaway there is that making these grants will give companies about two years of time to figure out what to do about this position," says Pizzitola. "That may mean making another grant, increasing compensation or giving that person more responsibility to keep them longer, or it may mean two years to focus on developing someone to replace the departing executive or looking for someone they can recruit externally."

Among grant receivers, the most common departure point was in the third year after succession, which accounted for 33 percent of those who left within five years and 29 percent of all who eventually departed. In contrast, the most common departure point for non-receivers was within one year of CEO succession, which accounted for 28 percent of those who left within the first five years, and 16 percent of all who eventually departed. "That's meaningful because that first year or two, when C-Suite retention is most tenuous, tends to be the most critical," says Cimi Silverberg, managing director at FW Cook. "That's when it is most important to maintain stability in the leadership team, because a CEO succession, even if it's well planned, can be pretty disruptive."

The study results also suggest that companies that use retention grants may want to reconsider their vesting periods, which typically range between three and five years. "A vesting period on the shorter end of the range, with award size calibrated appropriately, may be optimal, given that the effectiveness seems to dwindle after three years," notes Silverberg.

The Retention Grant Difference

Significantly more senior executives who receive grants stay on board for the critical two-year period following CEO turnover.



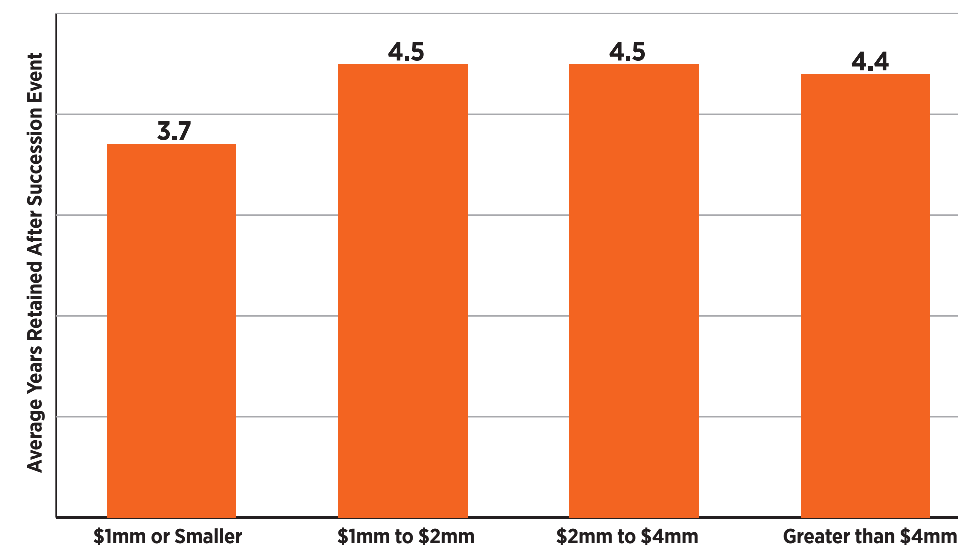
Grant Structures

The average (mean) size of a retention grant was $3.3 million and, on average, grants vest over 3.6 years.

	25th Percentile	Median	75th Percentile
Grant Values (in millions)	$1.1m	$2.5m	$4.1m
Vesting Schedule (in years)	3.0	3.0	4.1

Grant Size and Retention

The effectiveness of grants levels off after the $2 million mark.



MEANING OVER MONEY

The study also looked for a correlation between the size of grants and the duration of retention. Among those receiving grants, the average (mean) size of a retention grant was $3.3 million, and the 25th percentile, median and 75th percentile of awards had grant date fair values of $1.1 million, $2.5 million and $4.1 million, respectively. Initially, the more valuable the grant, the stronger its ability to retain—but once the grants passed the $2 million mark, their effectiveness in retaining executives showed a diminishing marginal return. In fact, the retention duration for executives receiving grants valued at between $1 million and $2 million was the same or higher as that of those receiving more than $2 million. (See chart, above.)

This may reflect the fact that some executives find reporting to a newly minted CEO, in some cases one who was once a peer, untenable—or that they had ambitions for the role themselves. "Basically, the retention grant is enough to help these executives stick around for a certain amount of time, but after that, regardless of the size of the grant, their career aspirations take over," says Silverberg, who points out that for C-Suite executives who might have been in the running for the top job, the lure of a CEO role is likely to trump any potential payoff. "There's almost no amount of money that can retain a non-CEO executive if they want and are offered the chance to be CEO somewhere else because the career development value of the CEO job is invaluable. So, even if the compensation level as CEO somewhere else isn't materially higher than what they're making, the opportunity to become CEO carries a significant value that a retention grant can't offset."

Absent interest in or opportunity for a CEO job, however, there are things companies can do in addition to retention grants—or instead of them—to help keep top talent after a CEO succession. "There are a lot of things that factor into what other retention strategies might be appropriate and effective," says Pizzitola. Other retention strategies, such as expanding responsibilities or offering rotational positions that dovetail with an executive's personal career goals, may also be appropriate and effective.

It's also key for boards to recognize that, in some cases, retention grants may be appropriate even when the CEO succession comes about due to plans for a broad change in strategy or management overhaul. "There are times when, as part of the transition, the intent is to eventually replace some of the other executives," he notes. "In those situations, there may still be value in making the retention grants anyway because then the company can make those decisions on its own schedule, on the CEO's own timeline."

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