PERFORMANCE-RELATED DEPARTURES OF CEOS REACHED RECORD LEVELS IN 2004, BOOZ ALLEN HAMILTON STUDY FINDS

CEO dismissals and other forced departures reached record levels last year, according to the fourth annual survey of CEO turnover at the world's 2,500 largest publicly traded corporations released today by strategy and technology consulting firm Booz Allen Hamilton. The study also found that boards of directors in North America are the slowest to remove underperforming CEOs, while boards in Europe are the quickest.

The study comprehensively examines the linkages between CEO tenure and corporate performance, comparing CEO turnover in major regions and in specific industry sectors. Among the findings:

- Globally, performance-related successions increased 44% from 2003, and represented 31.4% of all CEO departures in 2004. Overall, 14.2% of chief executives at the world's 2,500 largest public companies left office in 2004, compared to 9.8% in 2003.
  - The rate of CEO dismissals has increased by 300% from 1995 to 2004.
  - In 2004, 42% of CEO successions at European companies were related to performance, compared with 31% in the U.S.

- Overall, underperforming CEOs were removed after an average of 4.5 years in 2004. In Europe, CEOs removed for poor performance were in office for an astonishingly brief 2.5 years. Boards in North America were the slowest to remove underperforming CEOs, at 5.2 years.

- Regionally, the succession rate was highest in the Asia/Pacific region (excluding Japan), where 17.5% of the largest companies changed their CEO – a 230% increase over 2003. The next highest CEO succession rate was in Europe, at 16.8%, followed by Japan at 15.5% and North America, at 11.7%.

The firm's study, "CEO Succession 2004: The World's Most Prominent Temp Workers," is being published in the Summer 2005 issue of *strategy+business*, Booz Allen's quarterly thought leadership magazine, which goes on sale on newsstands in June.

The study's results reveal a growing haste to remove chief executives who fail to deliver strong results in the first few years of their tenure. "Business has entered the era of the short-term chief executive," notes Charles Lucier, senior vice president emeritus of Booz Allen Hamilton. "The age of the ephemeral CEO is here."

In fact, CEO turnover now matches the normal attrition rate for all employees. According to quarterly surveys by the research publisher BNA Inc., the typical employee turnover rate in the U.S. is about 12% per year, excluding layoffs and temporary employees. At 11.7%, the total rate of U.S. CEO departures in 2004 is equivalent to the overall rate of U.S. employee turnover. "From the perspective of turnover, the CEO is just another employee," Lucier said.

The study reveals an unintended consequence of shareholder activism: an even greater likelihood that executives will focus on delivering short-term results at the expense of strategies that create long-term shareholder value. "CEOs need an agenda that puts the company on the right strategic path, but that also produces short-term wins that don't hurt the company in the long run," notes Booz Allen senior vice president Reggie Van Lee.

Key Study Findings

- **Underperformance – not ethics, not illegality, not power struggles – is the primary reason CEOs get fired.** Forced turnovers are strongly correlated with poor shareholder returns. During the year before they left, dismissed CEOs had generated median regionally adjusted returns that were 7.7 percentage points lower than those who left office under normal conditions.

- **New chief executives hired from the outside inherit companies in much worse shape than those inherited by insiders.** For the CEO "class" of 2004, outsider CEOs joined companies whose shareholder returns averaged 5.2 percentage points lower during the preceding year than companies that promoted insiders.

- **CEOs are retiring at ever-younger ages**. An increasing proportion of successful chief executives age 55 or younger are choosing to retire. In North America, 17.5% of CEOs who stepped down as part of a planned transition in 2004 were 55 or younger, an increase of 61% over the prior year.

- **The Sarbanes-Oxley Act (SOX) of 2002 did not force more CEO turnover in the U.S.** The upward shift in CEO firings occurred from 1995 to 2000; subsequent rates of overall turnover, dismissals, and tenure are all consistent with pre-SOX trends.

- **Europe and Asia (excluding Japan) have become the most demanding environments for CEOs.** These regions have the highest overall turnover, the most firings, the shortest tenures, and the most rapidly increasing rates of turnover. Europe's turnover rate of 16.8% is 425% higher than 1995, the first year Booz Allen tracked CEO successions. The Asia turnover rate of 17.5% (excluding Japan) is 256% higher than 1995 levels.

- **A former CEO who stays as chairman creates a drag on performance.** Companies in which a retired chief executive stayed on as chairman (46% of companies) underperformed other firms by a regionally-adjusted 2.8 percentage points annually.

- **Successful companies are more likely to fire a new CEO.** Contrary to conventional wisdom, companies that performed well during the two years prior to their CEO's appointment have been one-third more likely to force that new CEO from office. Companies that struggled before their new CEOs came in were more likely to keep them longer.

Industry-Specific Findings

- **Highest-Risk Industries:** In 2004, the industries that saw the highest rates of CEO turnover were industrials (19.5%), utilities (19.0%), healthcare (16.2%) and telecommunications (16.0%). Between 1995 and 2004, telecommunications companies had the highest CEO turnover rate (12.7%), followed by industrials (12.3%), energy (11.7%), and utilities (11.6%).

- **The Safest Industries:** The energy industry was the safest for CEOs in 2004, with an overall succession rate of 10.3% during the year. Other industries with low rates of CEO turnover in 2004 include materials (10.4%) and information technology (12.4%). Between 1995 and 2004, financial services companies had the lowest overall CEO turnover rate (8.6%), followed by consumer staples (10.2%) and information technology (11.0%).

- **Forced Turnover:** Paradoxically, although recording one of the lowest overall succession rates, information technology had the highest rate of performance-related turnover in 2004 (44.8% of all CEO successions in the industry). Telecommunications (42.9% of total industry turnover), and consumer staples (36.8% of total industry turnover) rounded out the top three.

Methodology

Booz Allen studied the 354 CEOs of the world's largest 2,500 publicly traded corporations who left office in 2004, and evaluated both the performance of their companies and the events surrounding their departures. To provide historical context, Booz Allen evaluated and the compared this data to information on CEO departures for 1995, 1998, 2000, 2001, 2002 and 2003. This year, we expanded our data set to include the financial performance of companies in the years before each CEO assumed office.

For the purposes of the study, Booz Allen classified CEO departures as either:

- *Merger-driven,* in which a CEO leaves after his or her company is acquired by or combined with another.
- *Performance-related*, in which the CEO was forced to resign, either because of poor performance or disagreements with the board.
- *Regular transition*, which includes all planned and long-scheduled retirements, as well as health-related departures or death in office.

About Booz Allen Hamilton

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for 90 years. Booz Allen, a global strategy and technology consulting firm, works with clients to deliver results that endure.

With more than 16,000 employees on six continents, the firm generates annual sales of $3.3 billion. Booz Allen provides services in strategy, organization, operations, systems, and technology to the world's leading corporations, government and other public agencies, emerging growth companies, and institutions.

Booz Allen has been recognized as a consultant and employer of choice. In a recent independent study by Kennedy Information, Booz Allen was rated the industry leader in performance and favorable client perceptions among general management consulting firms. Additionally, for the past six years, Working Mother has ranked the firm among its "100 Best Companies for Working Mothers" list. And in 2005, Fortune magazine named Booz Allen one of "The 100 Best Companies to Work For."

To learn more about the firm, visit the Booz Allen Web site at www.boozallen.com. To learn more about the best ideas in business, visit www.strategy-business.com, the Web site for strategy+business, a quarterly magazine sponsored by Booz Allen.

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