AGENDA

Stock Price Swings Following CEO Deaths Hold Clues for Boards

Spikes or slumps in stock price after a CEO dies can point to governance problems, a new paper states

By Frederic Lee | November 13, 2023

A new paper analyzing the impact of CEO deaths at public U.S. companies across three decades suggests that stock price reactions to a CEO's passing can predict the company's later operating performance. Price swings can also offer clues about what investors think of the board's performance on succession planning and executive compensation.

If boards do their job well, there should be no instances in which stock prices increase by 5% or 10% in response to a CEO death, **Dirk Jenter** of the **London School of Economics and Political Science** and one of the authors of the paper, told Agenda in an email. And yet, the data shows that sometimes happens.

In some instances, a CEO death may push stock prices up, which Jenter says "suggests that the wrong CEO was in office, or that the CEO was paid much more than justified by their contribution to the firm."

Boards need to regularly revisit the question of whether their incumbent CEOs are still the best choice, and they need to be more aggressive about replacing CEOs who aren't, said Jenter.

To view the graphic, click here or go to https://www.agendaweek.com/c/4311794/558954?referring_content_id=4311794&referring_issue_id=558954

The paper, called "Good and Bad CEOs," analyzed 449 CEO deaths in publicly traded U.S. firms between 1980 and 2012. The strongest predictors of having the wrong CEO, as evidenced by positive stock price reactions to their death, is high CEO age and long CEO tenure, said Jenter.

"Thus, boards should look especially carefully at CEOs who are beyond the typical retirement age and have been in office for a long time," he wrote, adding that even though a CEO might have been a great match for the firm at one time, the data shows that investors think that can change.

Theoretically, if boards maximized shareholder value, there should never be a situation where stock prices react positively to the death of a company's CEO, according to the paper, which was published in October 2023 and coauthored by **Egor Matveyev** of the **Massachusetts Institute of Technology** and **Lukas Roth** of the **University of Alberta**.

Spikes or slumps after a CEO dies can point to governance problems, the paper notes.

Stock prices tended to fall sharply when the deceased CEOs were relatively young, but tended to rise when they were older than average — and especially when they were also long-tenured, the paper notes.

Further, stock price reactions to sudden deaths were negative in firms in which CEOs were likely to be more important or difficult to replace, such as small and newly listed firms, according to the findings.

Aside from CEO exits having to do with illness or death, turnover usually coincides with other changes at the company that impact productivity — which makes it difficult to tell whether variation in performance is due to differences in leadership, according to a post about the paper on the **Harvard Law School** Forum on Corporate Governance. Age and tenue tend to be the factors that impact market reaction to such deaths most, according to the post.

"While the average stock price reaction to CEO deaths is small, we document large negative reactions to many deaths and large positive ones to many others," the post stated. In fact, in about 10% of cases, stock prices dropped by 13% or more in the four days around announcements. In another 10% of cases, share prices jumped by 11% or more, they found.

Jenter told Agenda that he was surprised to find positive stock price responses to a significant number of CEO deaths. "There are lots of reasons why stock prices should react at least somewhat negatively to CEO deaths — the incumbent CEO should usually be better than the successor, succession planning might be incomplete and the successor might need time to learn on the job," he said.

Additionally, the findings suggest that boards are especially struggling with the timely replacement of founder CEOs.

"Surprisingly many deaths of old, founder CEOs are greeted by large stock price increases," said Jenter. Even founders can stay too long — "and many apparently do," he noted.

Conversely, deaths of young founder CEOs typically cause large stock price falls, the researchers found.

How to Tell the Public

In terms of framing announcements that a CEO is ill or has passed away, companies should have a communication strategy in place that includes the identification of an interim CEO, whether it be a member of management, an existing director, or an external professional, **Amy Rojik**, leader of the **BDO** Center for Corporate Governance, told Agenda by email. Companies should also be ready with communication internally and externally to address and mitigate the concerns of employees, customers, shareholders and others.

Prompt communication is key in this type of situation, said Rojik. "A pre-determined spokesperson should explain any interim CEO coverage, the company's next steps and estimated timing for installing a longer-term CEO."

According to Rojik, maintaining control of the narrative ensures that accurate information reaches all stakeholders and limits speculation.

The uncertainty of the situation may still impact the stock price, but being transparent and proactive can mitigate such impact. Companies should leverage their communications teams, including legal, investor and public relations, human resources, and marketing, to prepare communications that protect the company, as well as the privacy and legal rights of the infirm or deceased CEO and his or her family, said Rojik.

CEO Selection and Shareholder Value

The rise of CEO pay rise over the last 40 years has created a “contentious debate” over whether CEO pay levels can be justified by those CEOs’ contributions to a company’s value, and the findings from the paper add to both sides of this debate, the authors state.

The fall in stock price linked to many CEO deaths indicates that their companies were worth more under the incumbent, and that these CEOs weren’t extracting all the value they create. Yet on the flipside, the stock price increases linked to many other CEO deaths suggest that those CEOs lowered shareholder value — either because they weren’t the right match for the company or because they were overpaid, according to the post.

Rojik told Agenda that there are a few steps boards should take when it comes to selecting a CEO who will maximize shareholder value.

“First, directors need to understand who their shareholders are and what they value, and how they evaluate their next CEO should reflect those answers,” said Rojik. After that, the board should have a clear, multifaceted CEO selection and onboarding process that sets the final selected candidate up for success.

Rojik said that key abilities for CEO candidates include those who can lead with integrity and keep the values and mission of the company top of mind, clearly define the goals and priorities of the organization and bring critical stakeholders to the table in designing and executing on the corporate strategy.

The CEO selection process itself should reflect the current state of the organization, as well as specific expectations of the CEO to determine who can best guide the organization to realize its strategic vision, said Rojik.

Boards should consider the scope of their CEO search, said Rojik, adding that if their search is internal, boards should evaluate whether they and the management team have proactively created an internal pipeline of candidates that could assume this critical role.

If their search is external, boards must assess their access to viable candidates — whether it be through reputable search firms, recommendations of trusted advisors or other connections — who can be put forward without biases and vetted against the defined needs of the company, she said.

Further, Rojik said that developing the right enticements to attract and retain qualified candidates requires boards to compile a transparent compensation and benefits package that incentivizes behaviors that align with the organization’s goals while balancing shareholder expectations.