The Hottest Corporate Fad: Pay CEOs to Find Successors
Intel, EMC, Avnet, Terex Reward Leaders for Preparing to Pass the Baton

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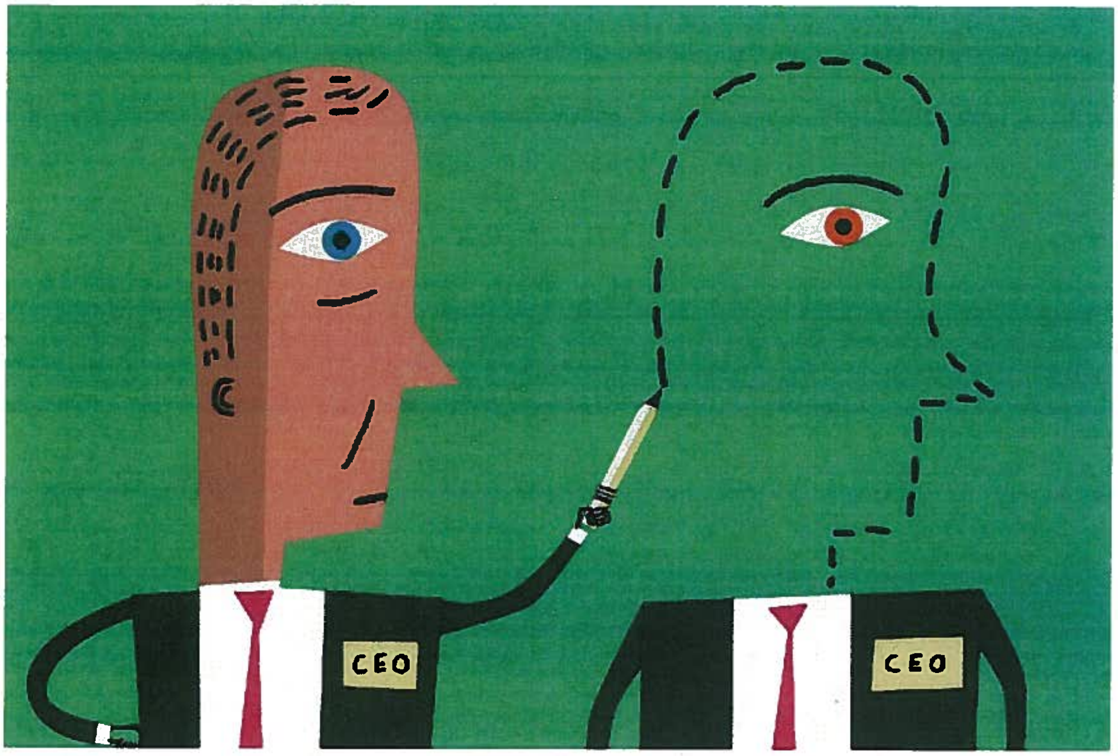

James Yang

No one likes giving up the power, privileges and perks of the corner office. So, some boards have begun paying chief executives extra to replace themselves.

Take former Intel Corp. chief Paul Otellini. He has received $4 million in stock and cash since January 2013, partly for helping to groom his successor, Brian Krzanich, elevated to CEO last May. Mr. Otellini can sell half of his $3 million worth of shares in the chip maker this May. He already took in $1 million in cash.

Spurred in part by investors' anxiety over rocky corner-office transitions, big businesses such as EMC Corp. , Avnet Inc. and Terex Corp. are rewarding leaders for preparing to pass the baton. Sixteen Fortune 1000 companies divulged links between the chief's performance awards and succession planning in their latest regulatory filings, with most disclosing the links for the first time since 2011, according to an analysis for The Wall Street Journal by Equilar, a research firm. But that number will grow rapidly in the next few years, governance experts predict.

Typically, a portion of the top boss's annual bonus depends on how well he or she did at succession planning; the amounts paid vary. Yet it is unclear whether these measures lead to smoother transitions.

"Poor CEO succession planning can cost shareholders a lot of money," says Paul Hodgson, a principal at governance consultants BHJ Partners. Leaders recently lasted less than two years at Symantec Corp. J.C. Penney Co., Martha Stewart Living Omnimedia Inc., RadioShack Corp. and Yahoo Inc. None had an insider ready to become CEO.

Every chief executive knows his or her days are numbered, but some resist succession planning, leadership specialists say. Yet even for this well-paid group, "money does matter. And money talks," suggests David S. Pottruck, head of the Intel board's compensation committee.

The number of major companies offering their leaders incentives for exit preparations likely will triple in five years, predicts Patrick McGurn, special counsel for proxy advisers Institutional Shareholder Services Inc. Boards know that "nothing tends to focus CEOs' attention like... good, swift kicks to their incentives," he adds.

As directors become increasingly involved in grooming talent, tying CEO pay to such efforts will be commonplace in a decade, says Dennis Carey, a vice chairman of recruiters Korn/Ferry International and co-author of the book "Boards that Lead."

Intel directors began Mr. Otellini's "success equity" program in early 2012. They initially bestowed restricted shares with a target value of $2 million. To earn them, he needed to take steps to "ensure a smooth transition, including succession planning," a regulatory filing stated.

"We were really serious about this," Mr. Pottruck remembers. Succession planning "was core and central to the [CEO's] job."

In November 2012, the 62-year-old Mr. Otellini decided to retire early the following May. Intel then was trying to restore its sway over the high-tech sector amid an industry shift to mobile devices.

"Paul handled himself very well in a very difficult period," Mr. Pottruck says. Nevertheless, the ex-chief got half the maximum payout of $4 million worth of shares for 2012 because he didn't develop certain possible successors in ways "we wanted him to do," the director continues.

Mr. Otellini declined to comment on the Pottruck criticism. He earned the remaining $2 million award for his "success equity" actions in 2013, with half paid in cash. He can sell the rest of the shares in May 2015.

Did the award make the difference? "Succession was always on my mind," the retired CEO observes, adding, "I can't say I worked any harder" to collect the special award. (Mr. Otellini's successor doesn't yet have a succession award.)

Some other companies hold a relatively new leader financially accountable for his or her eventual exit. Technology distributor Avnet Inc. promoted Richard "Rick" Hamada to CEO in July 2011, and his next annual raise will depend in part on his succession preparations, says Avnet Chairman William H. Schumann III. Directors introduced the pay link "to make sure the process is started sooner rather than later," he notes.

Though the 56-year-old Mr. Hamada says he hopes to run Avnet for a total of eight to 10 years, he now gives detailed succession updates during every board meeting—and feels "very comfortable with that level of accountability." With the board's clear mandate, "I am working smarter," he adds.

It is a slightly different situation at Marriott International Inc., where Arne Sorenson ascended to CEO in spring 2012. He long had been seen as the likely successor to J.W. "Bill" Marriott Jr., who held the top spot for 40 years. Mr. Sorenson represents the third CEO in the company's history and first from outside its founding family.

Board members believe that "continuity of management is critical," says David Rodriguez, chief human-resources officer for the hotel chain. So they based Mr. Sorenson's 2012 bonus partly on the CEO transition—including whether he secured the board's buy-in for his agenda, Mr. Rodriguez says. He estimates that roughly 10% of the nearly $1.95 million bonus reflected such individual achievements.

The HR executive expects Marriott directors will make successor development a specific bonus objective for Mr. Sorenson starting next year. It appears the 55-year-old leader will be ready. Four days after his appointment, Mr. Sorenson told Mr. Rodriguez that he wanted to initiate discussions about his own succession "at the very next board meeting."

Rewards linked to succession don't always last long, however. Autodesk Inc., a maker of design software, gave CEO Carl Bass 110,000 performance shares in March 2012, with the payout depending on several factors. He earned 15,725 shares a year later for his "management of executive talent," its latest proxy stated. The phrase covered succession planning, people familiar with the situation say.

But last year, Autodesk directors dropped such qualitative measures because stockholders prefer greater use of quantitative targets for CEO compensation, the proxy said.