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Evaluating Compensation in CEO Succession Decisions



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How to Use This Tool

Board chairs, relevant committees (e.g., compensation, human capital, talent, succession), and senior leaders supporting the board can use this tool during succession planning, candidate evaluation, executive sessions, and other discussions. It will help the board compare the compensation implications of internal and external CEO appointments, protect alignment across the executive team, and prepare a clear investor and stakeholder rationale.

Start With the Leadership Mandate, Then Design Pay

Before compensation planning processes begin, the board must define the future CEO profile. The profile should reinforce the capabilities, strategic priorities, and time horizon the organization needs next, rather than simply clone the incumbent CEO's overall experience profile, strengths, and areas for improvement.

An internal promotion and an external recruit create different compensation pressures. The board should distinguish recurring compensation from one-time transition costs, assess internal pay relationships, and decide what the package signals about continuity, transformation, and risk.

Compare Internal and External Hire Pay Implications

Issue	Internal CEO Candidate	External CEO Candidate

Base pay and internal equity	▪ Reflect their responsibility expansion into the new role. ▪ Avoid using title alone to justify positioning—an internal candidate with no prior CEO experience may warrant a pay opportunity below median. ▪ Test the resulting pay against the pay of other senior executives to identify compression, inversion, or unexplained gaps.	▪ Know when you are positioning pay above market as a recruiting strategy. ▪ Consider how a premium may affect the credibility and retention of established executives who carry significant institutional knowledge and responsibility.
Annual incentives	▪ Use common enterprise financial measures, with differentiation, where appropriate and allowable within the incentive plan structure through leadership effectiveness, team development, crisis performance, and cross-enterprise collaboration. ▪ Align incentives with other members of the senior executive team.	▪ Balance near-term business performance with onboarding, strategic assessment, talent decisions, and relationship building. ▪ Avoid incentives that encourage rapid change before the CEO understands the organization. ▪ Align incentives with other members of the senior executive team.
Long-term incentives (LTIs) and one-time awards	▪ Use time- or performance-based awards that support long-term performance alignment and retention goals. ▪ Avoid awards explicitly contingent on becoming CEO or that prematurely crown a successor. ▪ Align LTI design with other members of the senior executive team.	▪ Separate annual LTI design from make-whole one-time awards, sign-on incentives, and replacement equity. ▪ Document the purpose, valuation, vesting, and conditions of each component so transition costs are not confused with recurring pay.

Executive team effects	▪ Plan for the treatment of near-miss candidates, backfills, and changes in reporting relationships. ▪ Retention actions should preserve collaboration rather than turn succession into a tournament.	▪ Identify which executives are essential to continuity and whether the new CEO can work effectively with them. ▪ Consider whether selected members of the senior executive team need enhanced retention-based compensation programs because their skill sets complement those of the incoming CEO. ▪ Avoid automatic or broad-based retention payments without a business case.
Departing CEO arrangements	▪ Review retirement treatment, severance, consulting arrangements, and outstanding incentives so the transition does not create overlapping authority or conflicting incentives.	▪ Apply the same discipline, with particular attention to whether transition support for the outgoing CEO duplicates the incoming CEO's responsibilities or extends influence beyond the board's intent.

Compensation Scorecard for a New CEO

Reserve time in executive session to assess CEO performance against agreed-upon measures and the execution of strategic objectives. The scorecard below is a template, not a prescribed formula; the committee should tailor the measures, evidence, and weightings to the organization's strategy and document how judgment is applied. The weightings below are relevant if the board desires to incorporate succession-related metrics into the CEO's annual incentive opportunity. Alternatively, the board can discuss these areas outside of the annual incentive framework.

Performance Area	Illustrative Evidence	Weight/ Role	Assessment Scale

Strategy execution	▪ Progress against board-approved priorities ▪ Quality and timeliness of decisions ▪ Responsible risk management	0–10% STI* or modifier	Below/Meets/Exceeds
Leadership bench strength	▪ Depth and readiness of C-suite and operational candidates ▪ Completion of development plans ▪ Credible successors at defined time horizons	0–10% STI or modifier	Starting/Progressing/ Ready
Critical talent retention	▪ Retention of essential enterprise, technical, regulatory, and financial leaders ▪ Regrettable losses ▪ Mitigation actions	0–10% STI or modifier	Below/Meets/Exceeds
Cross-functional development	▪ Stretch roles ▪ Rotations ▪ Coaching ▪ Board exposure that builds enterprise leadership capability	Qualitative STI	Limited/Effective/Strong
Succession outcomes over time	▪ Internal readiness ▪ Successful moves into key roles ▪ Leadership stability through transformation	Qualitative STI	Negative/Neutral/ Positive

** STI: Short-term incentive*

The board should determine which scorecard areas are most relevant to the CEO on an annual basis. Typically, the CEO's annual incentive scorecard is heavily weighted towards financial metrics (i.e., 75% or more), with 1–3 qualitative metrics, such as those illustrated above, weighted in aggregate no more than 25 percent. LTI opportunities for CEOs are

almost always weighted entirely on financial performance metrics.

While the compensation committee typically leads the CEO performance assessment process, results are always shared with the entire board to align board views on the CEO's effectiveness and to feed into CEO development and succession conversations.

Align the Package With the Senior Leadership Team

Evaluate the CEO package in the context of the full leadership team. Test whether changes in pay, role scope, reporting lines, and incentive opportunities support collaboration and shared enterprise goals, or create avoidable disparities that undermine trust.

For internal candidates, preserve competitive development and retention without promising the CEO role. After selection, determine how to recognize near-miss candidates, whether to expand roles, and which positions may need backfilling. For an external hire, assess whether the package and mandate will help the new CEO retain and work with critical incumbents rather than unintentionally trigger departures.

Prepare the Investor and Stakeholder Rationale

The board must be prepared to explain why the package is proportionate to the leadership challenge, how performance goals support the stated mandate, and why any one-time awards are necessary and nonduplicative. Investors may also examine whether:

- An internal promotion received a justified increase
- An external hire received an excessive premium
- The design demonstrates credible pay-for-performance alignment

The compensation narrative should distinguish ongoing pay, forfeited compensation replacement, recruiting premiums, and transition support. It should also explain how the board considered internal equity, retention of key executives, succession due diligence, and the expected balance between continuity and change.

Account for Organization-Specific Considerations

Public companies	■ Support compensation decisions with disclosure, investor relations, and transition communications. ■ Review how one-time awards, equity dilution, performance conditions, and the board's rationale may be viewed by shareholders and other external evaluators.

Private companies	▪ Consider the expectations of controlling owners, minority investors, family owners, or private equity sponsors. ▪ Clarify how equity value, liquidity, vesting, performance horizons, and potential exit timing affect the offer and internal pay relationships.
Tax-exempt organizations	▪ Consider mission alignment, affordability, stakeholder trust, the organization's ability to sustain the package, and the reasonableness of pay.

Questions for Boards

- Does the proposed pay package align CEO compensation with the organization's short- and long-term business strategies and goals?
- Does the proposed package reflect the different risks and costs of an internal promotion versus an external recruitment, including internal equity, make-whole awards, and one-time transition costs?
- How will the package affect collaboration, retention, role clarity, and pay relationships across the executive team, including near-miss candidates and critical incumbents?
- Can we explain to investors and stakeholders why the package is proportionate, performance-linked, and consistent with the leadership mandate?
- What compensation, disclosure, ownership, tax, or governance considerations are specific to our status as a public, private, or tax-exempt organization?
- Have we addressed the compensation and authority of the departing CEO so that transition arrangements support, rather than complicate, the new CEO's mandate?

This framework will help assess how the choice between an internal or external CEO affects pay design, executive team alignment, investor confidence, and the organization-specific governance requirements surrounding the transition.

About the Author

Ed is a consulting team leader with 25+ years advising boards and senior management on executive compensation for public and private companies to help design pay programs aligned with performance, governance, and stakeholder expectations.

About Pearl Meyer

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