Corporate Boards and the CEO Selection Process

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There is no more important responsibility for a board of directors than the selection and removal of the CEO, along with monitoring and evaluating the CEO’s performance. There is also no greater negative impact that a dysfunctional and divided board might have than on the CEO selection and removal process. Three recent cases demonstrate the importance of that claim – Hewlett Packard, Yahoo, and Pfizer. There are certain parallels between each case, but each case also reflects a different set of negative characteristics.

**Hewlett-Packard**

HP is the longest standing and most well known case of the three regarding its dysfunctional board. The internal divisions within the board have persisted over the tenures of the last three CEOs, and may not have subsided with the hiring of the latest CEO, Meg Whitman. The continual governance failures at HP have in turn damaged the reputation of the company. Former director Tom Perkins, who resigned following the privacy scandal provoked by the pretexting campaign launched by former chair Patricia Dunn, labels the HP board the “worst board in the history of business” and has charged HP with committing “corporate suicide.” *New York Times* columnist has called the HP board “the most inept corporate board” in America. As a result of its self-inflicted wounds and reputational damage, several HP customers have ceased their dealings with the company. Institutional Shareholder Services (ISS), the leading shareholder advisory firm and rating service, has assigned HP’s corporate governance a grade of “D.” Specific aspects of governance problems at HP include the following:

1. **A divisive culture within the board is difficult to correct:** The HP board has been rife with conflicts and animosities that have persisted over the tenures of the last three CEOs, and may not have yet subsided. There were internal divisions over the strategies of CEO Carly Fiorina, including the acquisition of Compaq Computer, which provoked a shareholder lawsuit by director Walter Hewlett. Subsequently, board chair Patricia Dunn authorized the surveillance of board members to detect any leaks and violations of confidentiality. That instigated a privacy scandal and provoked the resignations of board members Tom Perkins and George Keyworth, the latter charged with leaking confidential information. Following the selection of Mark Hurd as CEO to replace Fiorina, the board was then split over whether to fire Hurd when he was investigated for sexual harassment and expense account fraud. The board later converged over the
selection and eventual resignation of Leo Apotheker as CEO, who had formerly been CEO of SAP, though pre-existing animosities had damages the selection process.

2. **The divisive culture led to dysfunctional CEO searches:** Due to a company and governance system in need of repair, HP has been on the search for an outside savior since the selection of Carly Fiorina as CEO. Studies attest to the wisdom of cultivating inside candidates instead, and HP has paid a dear price for continually turning to outsiders. The board was divided over Fiorina’s strategy and then turned to another outsider in Mark Hurd, who had abilities in execution and financial management that supposedly compensated for Fiorina’s shortcomings. When the board later investigated Hurd for improprieties and illegal conduct, some board members supported him while others advocated his ouster. The division over Hurd had an adverse impact over the subsequent CEO search, resulting in the selection of yet another outsider in Leo Apotheker. Some directors declined to serve on the search committee, since one of its members had previously supported Hurd, and due to the poisoned internal culture, none of the directors even met with the top three candidates, including the eventual CEO Leo Apotheker. Many of the best candidates also rebuffed overtures from the board, due to HP’s recent sorry history of governance.

3. **Due Diligence has suffered in the board’s CEO searches:** As a result of the internal divisions and rancor over all the outside CEOs selected, due diligence also suffered, especially in the selection of Leo Apotheker. The lack of scrutiny into Apotheker’s background was startling. The board was not even aware of the problems at SAP, where he was former CEO, and the intellectual property lawsuits that had been brought by Oracle. Apotheker also had little experience in HP’s core areas of hardware and also lacked communication skills. Even when the board agreed with his strategy, Apotheker’s inability to communicate that strategy to employees and other stakeholders was a real liability and was one factor that led to his ouster. Meg Whitman, the former CEO of eBay and former California gubernatorial candidate, is the latest outsider CEO of HP, the result of a hasty search on the heels of Apotheker’s departure. With her communication skills, she certainly has compensated for one of Apotheker’s major deficiencies, but some have still criticized her selection, since she has never led a firm of such massive scale as HP, and even see it as an “unmitigated disaster.” Has HP continued its series of mistakes and failures of due diligence with her selection? That is yet to be determined.

4. **HP has suffered from undue influence by the CEO on the board:** When the board is so divided and unreliable, the CEO often fills the leadership vacuum by assuming too much power. That has been the case at HP. Fiorina and Hurd occupied the positions of both CEO and board chair for a time during their reigns, with Patricia Dunn serving in a disastrous fashion as independent chair
after Hurd first became CEO. The history of the divisive board that preceded Apotheker’s selection as CEO led him to exert influence in selecting five new board members after four others resigned following the ouster of Mark Hurd. Had the nominating and governance committee been in better shape, one would not expect a new CEO to assume that much power. Meg Whitman also exerted influence in having the board select Ray Lane board chair as a condition of her taking the CEO position, resulting in what some have called a co-CEO situation. With a stronger and unified board in place, Whitman might not have succeeded in making such a demand.

5. **Divided boards exacerbate CEO compensation**: Divided boards usually overpay for outsider or even celebrity CEOs, who can demand exorbitant compensation and severance payments. Carly Fiorina received a severance estimated at $22 million; Mark Hurd received a severance payment of over $12 million and millions more in benefits; and Leo Apotheker received a severance payment of over $13 million. Similar overpaid CEOs at the next two cases of Yahoo and Pfizer have also recently been ousted. Carol Bartz of Yahoo, who had formerly been CEO of Autodesk, received a sign-in package of $47 million. Jeffrey Kindler of Pfizer received a severance payment of $16 million, plus almost $7 million in benefits.

**Yahoo**

There is a series of different lessons to be gleaned from the governance problems at Yahoo that attended the recent ouster of Carol Bartz as CEO. While the problems at HP revolve more around CEO selection, the problems at Yahoo relate to the removal process, as well the failure of the board to pay attention to investors and to actively monitor and advise the CEO.

1. **Yahoo failed to follow an orderly process in removing the CEO**: The Yahoo case and the Pfizer example moved in opposite directions in removing the CEO. While the process at Pfizer was orderly, the process and board behavior at Yahoo were crude and haphazard. Three weeks prior to ousting Bartz as CEO, the board had actually expressed great confidence in her leadership. When the ax fell, the board chair fired her over the telephone, after giving her two hours to resign. There was no discussion or negotiation between the parties, beyond the sudden announcement, which in turn provoked a heated response from Bartz, as she hurled insults and expletives at the board. The process contrasted to the orderly process at Bank of America, where Sally Krawcheck had been terminated as president of the global division at Bank of America that same week, with an exchange of amicable words.
2. **Yahoo lacked an orderly process of replacing the CEO:** The CEO search issues at HP and Yahoo are quite different. While HP is an ongoing major enterprise, the future of Yahoo is uncertain. Further, while the divided HP board has made serious errors in its search process, Yahoo now seems to have no process at all. The company has had three different CEOs over the past four years, and it now is putting higher priority on the sale of assets over finding a new CEO. The former CFO is now the acting CEO, and the board has not yet even hired a search firm to produce candidate for the CEO position. While important strategic decisions have to be made, the board might meanwhile focus on finding a CEO capable of leading a downsized company or possibly a division of a newly combined enterprise.

3. **The board did not listen to comments and criticisms of major investors:** The board’s ineptitude in firing Bartz might have been avoided had the board listened more intently to leading investors. While the board had continually defended Bartz while the company was floundering, the leader of Third Point hedge fund had criticized the board for hiring Bartz initially and not firing her earlier. Greenlight Capital had expressed no confidence in corporate leadership and strategy by selling eight million shares in the second quarter of 2011. Since the Yahoo board had not heeded the advice of such important investors, they are now demanding that the chair and three other directors resign, and the board chair received only 60 percent of shareholder votes in the latest board election.

4. **The board did not actively monitor CEO behavior and performance, and did not hold the CEO accountable:** Beyond the failure of the board to listen to investors, it also did not adequately check CEO mistakes in judgment and operational decisions that stifled Yahoo’s chances for recovery. While the board did discourage her use of swear words and her abrasive style, the board did not adequately challenge more serious operational mistakes by Bartz. She had not handled the sales operation well and allegedly erred by going outside the company to hire a senior vice president for sales. She had also created a strained relationship with Alibaba, an Asian tech company in which Yahoo has a 40 percent stake. Finally, operational mistakes and poor employee relations had led to a high attrition rate among engineers and managers working for Yahoo.

5. **The board did not actively monitor the CEO on corporate strategy:** While the HP board and CEO clashed on strategy during both the Fiorina and Apotheker eras, there was at least a debate. Meanwhile, the Yahoo board did not engage and challenge more fundamental strategic decisions. The company’s stock value had been flat while that of other tech companies had gained 60 percent over the past two years. Time spent by visitors on the Yahoo web site had declined by one third, while display ads had declined in the face of surges on Google and Facebook. Hence, there were plenty of red flags. Over that time period, the
board had been heavily criticized for failing to sell the company at a substantial
premium to Microsoft while Jerry Yang had been CEO. Critics also found Yahoo’s
business model to be outdated and lamented its decision to partner with
Microsoft’s Bing to challenge Google in the search space. The board’s strategy
and transactions committee, headed by the CEO of Akamai Technologies, is now
finally reviewing Yahoo’s strategy.

**Pfizer**

The corporate governance and leadership selection process at Pfizer shares two of the
major problems already discussed at HP and Yahoo – failures of due diligence and undue
influence of the CEO over board decisions. There is meanwhile one process at Pfizer,
namely the CEO removal process, that has worked better than the practices at HP and
Yahoo.

1. **The board needed to heed early warning signals and emphasize due diligence
   in CEO selection:** In selecting Jeffrey Kindler as CEO, the Pfizer board might have
   expected the type of leader it needed at the time – a brilliant and hard-working
   manager who had successfully headed a division of McDonald’s, had previously
   worked in the general counsel’s office of General Electric before becoming
   General Counsel at Pfizer, and could navigate the challenging legal and
   regulatory environment that the pharmaceutical industry now faced. What it
   got instead was a confrontational and combative micro-manager who berated
   his subordinates and was allegedly also insecure and indecisive. His blunt and
   angry style did not fit the culture of a company based on scientific advancement.
   He had aggressively campaigned for the CEO position from his role as General
   Counsel but was weak at governing and leading. The company’s stock value fell
   40 percent under his leadership and his questionable acquisition and layoff
   strategy. He also ignored the advice of experienced managers at Pfizer, turned
   instead to droves of outside consultants, and heavily trusted only the human
   resources director he had selected as an outsider and one who manifested many
   of his same dysfunctional traits. Kindler displayed his confrontational manner
   even with board members, and the red flags were there to be seen. His own
   legal staff had warned the Pfizer board of his chaotic and combative
   management style, but the chair, a university president, had discounted the
   advice. Further, neither the board nor Kindler became aware of the negative
   terms of departure from Charles Schwab of the new and allegedly toxic HR chief.
   Evidence of the downsides of both Kindler and his HR chief was readily available
   but never pursued.

2. **The board needed to beware of the influence of a former CEO still on the
   board:** In contrast to the influence of current CEOs over the divided board at HP,
   the danger at Pfizer was posed by the influence of a former CEO on the board.
William Campbell Steere had been the long-time CEO of Pfizer until the 1990s, and many board members looked to him for advice and approval from his continual perch on the board after he stepped down as CEO. He continually clashed with CEO Henry McKinnell after Steere had influenced his appointment, until his ouster. Steere also supported the appointment of Kindler in 2006 over two more experienced insiders at Pfizer, and even secretly met with Kindler to map their campaign strategy, contrary to what corporate policy allowed. Once Steere reached the age of 72, the board even extended the retirement age to accommodate his service on the board until he retired at age 74.

3. **The board did have an orderly and decisive removal process:** Ending on a positive note, the Pfizer board in eventually removing Kindler as CEO did follow much better procedures than the clumsy process followed by Yahoo. The entire board first met with top corporate litigator Marty Lipton, experienced in corporate governance matters, for his guidance. Yahoo’s lead director then contacted all eleven members of the Executive Leadership Team for their assessments of Kindler. None supported him as CEO. Three outside board members, including a former congressman and a regulator, then met personally with Kindler at an airport, with 24 hours advance notice. They then listened to his defense of his performance, but there was no debate, and he was dismissed with a generous severance package. Ian Read, the former CFO who was contemplating retirement due to Kindler’s dysfunctional leadership, was then selected as the next CEO, presumably without Steere influencing the decision. Pfizer’s stock has since climbed 20 percent during Read’s era.

The common thread running through all three cases is that a corporate board needs to be fully engaged in both the selection and removal of the CEO and have an orderly process. A divided board will likely fail in those responsibilities, will ignore early warning signals and will not exercise due diligence. A complacent board will also be pliable and vulnerable to the influence of the CEO, past or present. The board also needs to actively monitor the performance of the CEO and have two-way communication with major investors, and today must also be engaged in discussing and formulating corporate strategy. The three cases of Hewlett Packard, Yahoo, and Pfizer have failed to meet a high standard of performance along those dimensions.