

The Board's Role in End-of-Employment Decisions

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In any industry, individual terminations and workforce restructurings are ongoing. CEO and C-level terminations are often governed by previously negotiated severance agreements contained within initial employment agreements. But these individuals are a minority within your company's employee population. What questions ought the board ask about end-of-employment decisions not governed by employment agreements?

The traditional board perspective is to keep its fingers out of tactical decisions like end-of-employment. And we agree that the board ought to keep its fingers out. But there are questions board members can and should be asking with a vision towards how end-of-employment decisions affecting the company's employee population may affect the company in the long run.

At the global management consulting firm McKinsey & Company, the majority of associates who enter the partnership track will leave the firm. There is an up-or-out talent system typical of most large professional service firms. End-of-employment, however, does not mean the end of the McKinsey relationship. End-of-employment is the beginning of membership in the McKinsey Alumni group. The company goes out of its way to assist departing professionals and maintains an active alumni group. The managing partner of McKinsey routinely visits McKinsey Alumni organizations around

the world to keep the relationship going.

McKinsey & Company sees departing employees as potential referral sources for future work. Taking care of departing professionals and retaining their long-term loyalty is not seen as personnel costs. It is seen as a marketing investment.

McKinsey would be on one extreme of the end of employment continuum.

At the other extreme, departing employees might be viewed with the same perspective as refuse disposal: "I want low cost and no lawsuits. I don't care what happens once it leaves the building." The position of the company is that "you are either on the bus or off the bus." And people who are "off the bus" are simply a cost.

Has your board and CEO ever had a discussion about where the company stands on this philosophical line? Should it have such a discussion?

Retaliatory Capacity and the Future Influence of Former Employees

When working with boards and CEOs on these issues, we are informed by Thomas C. Schelling's threat analysis framework. Schelling, the winner of the 2005 Nobel Prize for Economics, received the award for applying game theory to conflict. His focus was on the weapons issues, but we have applied his ideas to the design of employee termination packages.

Schelling says "uncertain retaliation is more efficient than certain retaliation" when bargaining and "the capability to retaliate is more useful than the ability to defend." Now let's apply these concepts to end-of-employment decisions.

If a company can assume that departing employees have little or no retaliatory capacity or have capacity but lack inclination, then a company can afford to focus on the "on the bus/off the bus" end of the continuum. Suppose one assumes that former employees will continue to be a factor in the firm's future? They have the capacity to legally retaliate

Director Summary: The traditional role of the board excludes input on end-of-employment decisions affecting rank-and-file members of the corporation. The authors assert that the board and CEO have an interest in considering fair treatment of departing employees as a means to secure long-term loyalty to the company and reduce potential retaliatory risks.



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against the company's interests. The perception that they were treated like refuse might induce them to harm the company. For example:

- They may join other organizations and become potential allies or opponents in the firm's efforts to gain/keep corporate clients or engage in mergers & acquisitions.
- They may become potential referral sources for your firm or a potential source of caution to others about doing business with the company.
- They may attend alumni programs at their graduate schools or colleges and encourage/discourage graduates from joining the company.

Each of these scenarios assumes capability of retaliation, company-induced motivation to retaliate, and uncertainty of that retaliation. It is impossible for companies to effectively defend against this trio of threats. The best practical risk-management tool is to reduce inclination to harm. In other words treat people with dignity on the way out because the assured costs of such treatment are less than the potential downside of future retaliatory risks.

Are Companies Employing Too Narrow A Perspective About Risk Management in End-of-Employment Decisions?

Termination discussions often involve the CEO delegating the issue to a trio of professionals: human resource leaders, employment/labor attorneys, and finance professionals. By defining the decision-making group in this way, the CEO biases the outcome to focus on cost containment, limitation of legal liabilities, and ease of administration. These are all important considerations, but board members need to ask their CEOs if this perspective is enough.

By not asking the right questions of the CEO, there is a danger that these important transaction/cost perspectives may dominate decision making at the expense of ignoring longer term and more costly risks.

To structure the end-of-employment discussions, we recommend that the board suggest that the CEO ask

his/her key associates in end-of-employment decisions to factor in the following considerations for departing employees.

Rate each factor on a 0-9 scale. A score of "0" means that the factor does not apply. "1" means "minor threat" whereas "9" means a "significant threat."

FACTOR

- ___ 1. Ability to harm M&A objectives.
- ___ 2. Ability to harm strategic alliances.
- ___ 3. Ability to negatively influence sales.
- ___ 4. Ability to negatively influence talent we seek to hire.
- ___ 5. Ability to negatively influence the community where we operate.
- ___ 6. Ability to negatively influence the regulatory environment where we operate.

If the CEO can answer these questions with confidence, then proceed with your end-of-employment deliberations. If you are uncertain what numbers to use, then ask the CEO to get the input from representatives from strategy, marketing, and regulatory affairs.

Conclusion

We love working for client companies that treat departing professionals with dignity on the grounds that treating people with respect is part of the corporate culture. We argue that if the role of the board is protection of long-term shareholder value, it is appropriate for board members to gently ask the CEO if the leadership team's approach to managing end-of-employment decisions is taking into account factors that will minimize threats to longer-term shareholder value.

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