CEO ATTRIBUTES AND FIRM PERFORMANCE

RESEARCH SPOTLIGHT
The Influence of CEOs on Firms

- Corporate stakeholders want to hire CEOs with superior managerial and leadership ability.

- However, the influence that CEOs have on firm outcomes (performance and risk) is not clear.
  
  - How important is the CEO to overall performance?
  - Do skills and backgrounds predict future performance?
  - Do personal attributes predict future performance?

Researchers find modest evidence to explain how CEOs influence firms, but the research is still evolving.
Thomas (1988) measures the contribution that an individual CEO makes to overall firm performance.


Measures the unexplained variance in profits, sales, and profit margin after controlling for economic, industry, and company-specific factors.

Finds that CEOs are responsible for 3.9% to 7.0% of firm performance.

Conclusion: CEOs do not have significant impact on overall performance.

“Leader differences do account for performance variation within firms… [but] these impacts are generally insufficient to outweigh the inbuilt differences among firms that largely account for performance variation.”
Mackey (2008) also measures the contribution of the CEO to overall performance.

- Includes only firms whose CEOs worked for more than one firm in the sample.

Finds that CEOs account for 29.2% of unexplained variance in company profitability (ROA) and 12.7% in business-segment profitability.

Conclusion: CEOs have significant impact on overall performance.

“The ‘CEO effect’ on corporate-parent performance is substantially more important than that of industry and firm effects.”
Hambrick and Quigley (2014) apply more detailed control mechanisms to measure the contribution of the CEO to performance.

Sample: 830 CEOs at 315 companies, 1992-2011.

- Industry controls are varied over time to account for changing conditions.
- Firm-specific controls are adjusted to account for performance of the firm at the start of each CEO’s tenure.

Find that CEOs account for 35.5% of firm outcomes (measured as ROA).

Conclusion: CEOs have significant impact on overall performance.

“Our technique generates appreciably different insights about the influence and efficacy of many individual CEOs, perhaps most notably those whose performance differs dramatically from what they inherited and whose influence endures beyond their tenures.”
Custódio, Ferreira, and Matos (2013) study the importance of general versus firm-specific managerial experience among CEOs.


General managerial skill measured by number of previous positions, firms, industries, prior CEO experience, and prior experience at a conglomerate.

Find that CEOs with general managerial backgrounds receive 19 percent higher pay than those with specialized backgrounds.

(Do not test relation between experience and future performance).

Conclusion: firms place a higher value on general managerial skill.
Falato, Li, and Milbourn (2015) study the associations between CEO experience, compensation, and performance.

Sample: 2,195 CEOs at S&P 1500 companies, 1993-2005.

Find that:

1. Companies pay a premium for CEOs based on industry credentials, reputation in the press, and educational background.
2. These pay premiums are justified based on subsequent performance (ROA).

Conclusion: experienced CEOs are paid more and perform better.
Cai, Sevilir, and Yang (2015) also study the relation between CEO experience and performance.

Sample: 2,335 CEOs at S&P 1500 companies, 1992-2010.
- Identify 36 companies (“CEO factories”) that train the most future CEOs. (e.g., General Electric, IBM, Procter & Gamble, and PepsiCo)
- Compare performance of 471 “factory CEOs” and 1,864 “non-factory CEOs.”

Find that:
1. Market reacts positively to appointment of CEOs from these companies.
2. Reaction is more positive the more years they spent at these companies.
3. These CEOs deliver superior 3-year future performance (ROA and Tobin’s Q).

Conclusion: high-quality managerial training is associated with positive future performance.

Sample: 316 CEO candidates at 224 private-equity owned firms, 2000-2006.
- Data from proprietary assessments that rate each candidate on 30 dimensions.

Find that attributes relating to work style (e.g., speed, aggressiveness, persistence, and work ethic) are more predictive of performance than personal attributes (e.g., listening, teamwork, and integrity).

Conclusion: managerial attributes might be predictive of future performance.

“There appears to be substantial variation in general managerial talent that is measurable and different from the usual observable characteristics such as age, industry, and SAT scores.”
Gow, Kaplan, Larcker, and Zakolyukina (2016) examine the relation between CEO personality and firm outcomes.

Sample:
- Start with detailed personality assessments of 119 CEOs.
- Develop linguistic model to categorize CEOs by “Big Five” traits: agreeableness, conscientiousness, extraversion, neuroticism, and openness to new experiences.
- Apply model to 4,591 CEOs using 70,329 conference call transcripts, 2001-2013.

Find modest evidence that CEO personality influences strategic decisions (e.g., R&D investment and leverage); and that extraversion is negatively associated with future performance (ROA and cash flow).

Conclusion: CEO personality might influence outcomes.
· Benmelech and Frydman (2015) study whether companies that have a CEO with a military background perform better.

· Sample: 4,013 CEOs, 2,402 companies, 1980-2006.

· Find that CEOs with a military background:
  – Are less likely to engage in fraudulent activity.
  – Might perform better during times of industry stress.
  – However, no overall impact on company performance or valuation.

Conclusion: CEO background might be predictive of corporate outcomes.

“Military service emphasizes duty, dedication, and self-sacrifice. The military may thus inculcate a value system that encourages CEOs to make ethical decisions and to be more dedicated and loyal to the companies they run.”
Bernile, Bhagwat, and Rau (forthcoming) study whether exposure to early-life disasters influences a CEO's subsequent risk tolerance.

- Identify natural disasters that occurred when CEO was 5 to 15 years old.
- Measure severity of natural disasters by death rate.

Find that CEOs who witnessed natural disasters with low (high) death rate subsequently lead firms more aggressively (conservatively).

Conclusion: CEO background might influence risk tolerance.

“Experiencing fatal disasters without extreme negative consequences desensitizes CEOs to the negative consequences of risk. In contrast, CEOs who witnessed the extreme downside potential of disasters appear to be more cautious in approaching risk.”
• Davidson, Dey, and Smith (2015) study whether corporate fraud is associated with a CEO’s personal lifestyle.

  – Matched pairs with similar firms that did not commit fraud.
  – CEO legal record: traffic violations, drug, alcohol, domestic violence, etc.
  – CEO spending: real estate ownership, boats, luxury vehicles, motorcycles.

• Find that CEOs with legal records are more likely to commit fraud and CEOs that spend lavishly on their personal lives lead firms with looser controls.

Conclusion: CEO personal background might influence corporate risk.

“Measures of executives’ ‘off-the-job’ behavior capture meaningful differences in managerial style.”
Wang, Holmes, Oh, and Zhu (2016) provide a comprehensive review of the research literature on CEO attributes and firm performance.

Sample: 308 studies, as of March 2015.

- Grouped by 5 measures: age, tenure, education, experience, and personality

Find that:

1. CEO age, tenure, formal education, and prior career experience are positively related to future performance.
2. Personality is related to strategic choices but not to performance.

Conclusion: CEO attributes might affect corporate performance.
There is widespread interest in the role that a CEO has on corporate outcomes and whether personal attributes influence their leadership choices.

Estimates of the contribution that an individual CEO makes to overall performance vary widely.

Modest evidence exists that personal and professional attributes are associated with their performance as managers:

- Previous experience and work style seem to be predictive of future performance.
- Personal choices and background are only modestly predictive.
- The importance of personality is unknown.

Research on this topic is still being developed.


