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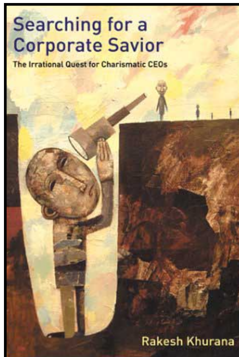

Searching for a Corporate Savior

The Irrational Quest for Charismatic CEOs

by Rakesh Khurana
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Take-Aways

- Companies today often appoint charismatic chief executives as corporate saviors.
- The search for a CEO is considered the most important job of the board of directors.
- Boards of directors are under increasing pressure from institutional investors.
- These shareholders often favor CEO replacement as a means of improving corporate performance.
- Such pressure encourages boards to focus on short-term gains in share price, which are most easily attained through the appointment of a high-profile CEO.
- By hiring a superstar CEO, a board placates investors, Wall Street analysts and the press.
- Boards unnecessarily limit their pool of candidates to well-known figures, eliminating many qualified individuals from inside and outside the company.
- Because this pool of potential candidates is so small, boards are forced to overpay.
- CEOs arrive with exorbitant salaries and the expectation that they'll save the company.
- Because CEOs have a limited ability to influence corporate performance, superstar CEOs eventually fail to meet expectations and the search process begins again.

Rating (10 is best)

Overall	Applicability	Innovation	Style
9	8	9	9

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Relevance

What You Will Learn
In this Abstract you will learn: 1) Why companies have embraced the superstar chief executive; 2) How institutional investors, Wall Street analysts and the business press influence the process of hiring, retaining and firing a CEO, and 3) Why and how boards of directors should revise the process through which they choose and appoint CEOs.

Recommendation
Charisma and reputation have replaced management experience and industry expertise in the corner office. Certainly that's not news to anyone who has read the business press at any time in the past decade, but the trend is certainly important enough to warrant the comprehensive examination provided by Rakesh Kurana. Starting with an analysis of the increasing power of activist institutional investors, Kurana traces the process through which boards of directors have forsaken mature managers for media darlings in their CEO searches. In light of the spate of embarrassing and enraging CEO scandals, *getAbstract.com* recommends this book to all readers.

Abstract

The Superstar CEO
The rise of investor capitalism and changing conceptions about business leadership have significantly altered the role of the chief executive officer. This shift is of critical importance to society as a whole, since the decisions made by CEOs affect the lives of millions of Americans. Due to the pervasive economic influence of major corporations, strategic choices of CEOs have ramifications that reach far beyond their own companies.

"The idea that the CEO's performance determines a company's fortunes may be a myth, but that does not make it any less powerful."

Institutional investors have been the driving force behind the change in the CEO's role. Institutions, which own a huge percentage of the shares of most publicly traded companies, have become more active in attempting to influence the direction of corporate management. In order to protect the value of their holdings, institutional investors have started pressuring corporate boards to make CEOs, and management in general, more accountable. This pressure has altered the relationship between CEOs and the boards that they once dominated, and in some cases, even served on.

This new relationship has produced a surprising result, however. Rather than hiring acquiescent CEOs who will do their bidding, corporate boards have instead turned to superstar CEOs whose high profiles can increase the confidence of shareholders and the general public, thereby shoring up share prices. The search for a new CEO has turned into a secretive process in which boards solicit the advice of outside analysts, investors and the business press. Generally, boards limit their searches to a small number of candidates who already posses great stature as well-known corporate chieftains. An emphasis is placed on the elusive qualities of leadership and charisma over industry knowledge and experience. As a result, many of the best candidates are disqualified long before the search even begins, while the contenders tend to share similar social, cultural and demographic characteristics.

"The standard profile of this savior is of an individual who has served as a CEO or president at a high-performing and well-regarded company."

When a business superstar is finally anointed as CEO, he — it's almost always he — is ushered in with an exorbitant salary and unrealistic expectations. The CEO is introduced

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to shareholders as the answer to all of a company's problems — a position that sets him up for nearly inevitable failure. When CEOs eventually fall short of expectations, boards quickly to replace them, setting the CEO search in motion once again. Unfortunately, this process erodes the stability of the company by placing its emphasis almost entirely on short-term share-price increases, rather than on long-term performance. CEO turnover also reduces the loyalty of upper management, and may even incite resentment if top executives have been passed over for the number-one slot.

"The widespread, firmly held belief in the overriding importance of the CEO is all the more noteworthy considering that there is no conclusive evidence linking leadership to organizational performance."

CEO Case Study: Bank One

The CEO turnover experienced by Chicago's Bank One Corp. in 1999 illustrates many of the business leadership changes that have occurred in the U.S. over the past 20 years. John McCoy had been an effective and successful CEO for much of his tenure since being appointed head of Bank One in 1984. The bank fell on hard times after its purchase of First Chicago NBD in 1984, however. Many shareholders blamed McCoy, citing especially his management style, which relied on his trust in subordinates and a high level of delegation. Eventually McCoy's critics won the day, he was ousted, and the company began a search for a new CEO.

The board appointed a former First Chicago executive, Verne Istock, as interim CEO. Istock was an experienced banker and manager who would have been an excellent choice for the CEO spot, but Wall Street and the business press demanded an executive with a higher profile in the financial services sector. Bank One found its man in James (Jamie) Dimon, a famous figure on Wall Street who had recently been ousted as president of Citigroup by his former mentor and longtime partner, Sanford (Sandy) Weill. After a brief courtship, the board extended to Dimon a five-year contract with a $1 million base annual salary, cash bonuses of up $4 million and a $7 million equity package.

"While it is often assumed that CEO searches are wide and extensive the external search is actually a very closed process."

The March 2000 announcement of Dimon's ascension resulted in wide praise from the business press and an immediate spike in Bank One's share price. Within several months however, the stock price relinquished these gains and critics began to question the board's choice. Dimon responded with a quick restructuring, removing several high-level Bank One executives, downsizing the board and filling key management slots with former Citigroup colleagues. The shake-up did nothing to halt the slide in shares of bank, which began to suffer from a decline in morale and increase in turnover on the part of its internal management and staff.

This example illustrates the danger of relying on a superstar CEO. Such a figure often will generate kudos and short-term stock price gains upon his arrival, but such excitement does not guarantee that the CEO has sufficient knowledge or ability to translate these short-term gains into long-term performance.

"To rationalize the organizational and monetary resources that go into recruiting the favored candidate, boards convince themselves that the person they have identified through the search process is, in fact, worth the effort and expense."

The Rise of the Charismatic CEO

The Bank One example illustrates the vicious cycle of the superstar CEO: Poor performance results in the ouster of a CEO. The board initiates a search for a replacement — often disrupting current performance to some extent — and emphasizes the qualities of leadership and charisma that will guarantee a positive reception from investors and the press. The process thus devolves into a search for a corporate savior: a superstar with a record of performance and a strong reputation with the financial community.

Only a few candidates survive this filtering process, and boards all too frequently come to focus on recruiting a single individual, often failing entirely to consider any

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internal candidates. The task then becomes convincing that person to accept the position, rationalizing excessive compensation with the logic that this is the only person who can meet their criteria. Based on the new CEO's expensive salary, investors and the financial community view the appointment as a vote of confidence by the board that this CEO will quickly solve the company's problems. When the CEO eventually, and almost inevitably, fails to single-handedly reverse the fortunes of the company, the same crowd quickly turns and begins pressuring the board to make a change. The whole process begins again…

"Rather than being what economists call a 'perfect' market, with large numbers of buyers and sellers engaged in relatively anonymous exchange, the external CEO labor market is one in which buyers and sellers — or at least those considered qualified sellers — are relatively few."

When directors place their blind faith in a charismatic CEO, they are introducing a strain of irrationality into what is expected to be a rational and carefully considered process. The disconnect arises from the fact that there is no firm evidence linking leadership or charisma with organizational performance. In fact, there is significant empirical data indicating that a variety of internal and external constraints limit a CEO's ability to affect ultimate performance outcomes. Internal politics, previous investments in fixed assets and particular markets, cultural norms in the company and external forces such as competition all serve to mitigate the influence of the CEO. Leadership ability comes into play most directly during crises, which are driven by large industry and economic factors and are therefore impossible to foresee.

Despite the limited ability of CEOs to affect corporate performance, cultural bias in the United States towards individualism discounts the influence of social, economic and political factors and exaggerates the role of individuals to influence very complex events. The media contributes to this phenomenon by explaining business events in terms of the personal characteristics and responses of corporate leaders, as opposed to analyzing the complicated business and economic forces that really drive performance.

"The shortage of qualified sellers is at its core a misperception largely driven by the fact that boards employ extremely limiting criteria to define the pool of eligible candidates."

As a result, the tenures, firings and appointments of CEOs become largely closed processes carried out by a relatively small group of individuals. Even when an outside search firm is retained, directors typically zero in on a few candidates already known to them and take into consideration the views of outside individuals, such as shareholders, analysts, and the press. As a result, search firms often become mere masters of ceremonies, as opposed to real brokers.

A Restricted Marketplace

Astronomical CEOs salaries seem hard to justify when looked at from outside the boardroom. But for directors, the salaries and bonuses that they dole out are a simple response to the basic forces of supply and demand. In a perfect market, there are a large number of buyers and sellers involved in a relatively anonymous interchange. In the CEO market, however, here are very few buyers and sellers, or at least sellers that are considered qualified by the buyers. Virtually the only candidates that will be considered are those with previous experience as CEOs who will meet the approval of the press and the financial community.

"Both candidates and boards of directors lack the information necessary to make informed decisions."

The necessary obsession with confidentially and secrecy on both sides — the board and the candidates — means that both camps lack information that would be required in order to make an informed decision. An employed CEO cannot allow anyone to know that he is considering offers, lest he undermine his current position. Boards seek to keep their plans to replace a CEO secret for as long as possible, for obvious reasons. Search firms help to span this breech to some extent, but since they are inherently bound by the restrictions set by the boards themselves, they often simply produce the illusion that the search is more far-reaching and objective than it really is.

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"Confidentiality also becomes an issue when obtaining information about a candidate's skills or capabilities, since such information cannot be obtained directly from his or her current employer."

"The entire search process is orchestrated to produce a corporate savior, to find a new CEO whom investors and the business media regard as a star."

The Board's Most Important Job

Gone are the days when an outgoing CEO could choose his own successor from the ranks of his executives. Just 20 years ago, new CEOs generally came from within a company. They were chosen on the grounds that internal executives possessed the knowledge and skills needed to guide the firm. Under this process, the keys to the corner office were years spent honing managerial skills and industry expertise. These qualities have been jettisoned in favor of the pure glamour of superstar CEOs. This change mirrors the shift from managerial to investor capitalism. Under the regime of managerial capitalism, which is marked by the separation of ownership and control and the hiring of professional managers, managers wielded power that was constrained largely by government regulation. Corporate directors were loyal to the CEOs who invited them to join their company's boards.

Under investor capitalism, institutional investors — now the dominant class of shareholders in the United States — began to advocate weaker government regulation and more power and control for themselves. Their reasoning: It becomes difficult for institutions to sell their huge positions when companies perform poorly. These institutions now demand that management respond to their concerns. One of the first demonstrations of this new power occurred at General Motors in 1992, when institutional shareholder pressure forced the board to oust a number of senior managers. Encouraged by activist shareholders, directors in the past decade have dismissed underperforming CEOs at Apple Computer, Xerox, Lucent, IBM and many other companies.

The search for a new CEO is now seen as the most important job of any board of directors. It's hardly surprising then, that boards would tend to hire well-known and charismatic CEOs and use their own business and personal connections to find and approach them. Using a search firm to bestow credibility, boards thus crown new Napoleons, who are richly rewarded and expected to single-handedly break patterns of poor performance.

The dangers of this process are becoming increasingly clear. The simplest way to mitigate these perils is to open up the CEO search. Directors must accept the reality that no single individual can save an organization. They must forgo the myth of the charismatic CEO and focus more on questions of strategy, industry conditions and other real determinants of corporate success or failure. In short, we must bring back real management expertise and knowledge and forget about our search for the corporate savior.

About The Author

Rakesh Khurana is an assistant professor of organizational behavior at Harvard Business School. He began this project as his 1998 dissertation: *The Changing of the Guard: Causes, Process, and Consequences of CEO Turnover*, using a database of all the CEO turnovers in the 850 largest American corporations from 1978-1996.

Buzz-Words

Corporate savior / **M**anagerial capitalism / **I**nvestment capitalism / **C**EO marketplace / **I**nstitutional investors / **S**uperstar CEOs

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