



## CEO charisma, compensation, and firm performance

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### Abstract

We examined the relationships among CEO perceived charisma, CEO compensation packages, and firm performance in a sample of Fortune 500 companies over a 10-year period. CEO charisma ratings obtained from company CFOs and VPs for HRM were directly related to total CEO pay but not to any firm performance measures. CEO perceived charisma also was related to shareholder value, under highly uncertain conditions. In essence, charismatic CEOs seem able to influence their compensation packages and stock prices but not other indicators of firm performance. Implications for future charismatic leadership research and CEO compensation–firm performance work are discussed.

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*Keywords:* CEO perceived charisma; Firm performance; CEO compensation packages; Crisis and uncertain conditions

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### 1. Introduction

Conventional wisdom, supported by research, is that CEOs have strong effects on organizations (Reinganum, 1985; Smith & White, 1987; Thomas, 1988). Recognizing this point, many researchers

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and practitioners have agreed with Bennis and O'Toole's (2000) call for boards of directors to choose more effective CEOs by focusing on leaders with more than just standard managerial competencies and who demonstrate "integrity, provide meaning, generate trust, and communicate values" (p. 171). The basis for this argument, calling to mind examples such as Intel's Andy Grove, Corning's Roger Ackerman, and TIAA-CREF's John Biggs, is that some very effective CEOs appear to have characteristics associated with charismatic leaders, and that such leadership results in superior firm performance.

That the success of these CEOs can be attributed to their charisma, however, is based upon nonsystematic observations by the popular press and some academics. However, others who have looked at this same issue in more systematic ways are not in complete agreement with this conclusion because the little existing empirical evidence raises questions about the generalizability of "charisma" as a critical attribute for CEO success. For example, Collins (2001) examined companies that had substantially outperformed the market and their industry over 15 years and concluded that the best chief executives are not terribly charismatic, but rather nurture talent in their companies. The situation is further exacerbated by how charismatic CEOs are compensated. The results of a study by Khurana (2002) concluded that when hiring "charismatic" CEOs, boards of directors granted them extremely large compensation packages that included high salaries, bonus opportunities, and stock options, that have been termed "outrageous" by some critics (Krugman, 2002).

In this study, we examine these issues, framing them in terms of the following two questions: Do organizations led by charismatic CEOs outperform those headed by less charismatic CEOs? What is the compensation of charismatic CEOs, relative to other, less charismatic CEOs?

## 2. CEO charisma and firm performance

Charisma is based on the feeling of oneness that a person has with another, the desire for that feeling, or the personal attraction to be like the other: the stronger the attraction, the stronger the power (Bass, 1990; Fiol, Harris, & House, 1999). Those who are attracted to the charismatic leader trust the leader's beliefs, are emotionally involved with the leader, and believe in the leader's ability to accomplish the mission (Weber, 1947). Two recent theoretical perspectives have been proposed to explain the link between CEO charisma and firm performance. One, by Cannella and Monroe (1997), focused on how charismatic CEOs develop relationships to ensure the effective implementation of strategic decisions. They proposed that charisma and inspirational leadership are relevant because of their association with the *implementation* of the strategic decisions, and not so much because of their relationship to the *choice* of strategies.

The other, by Waldman and Yammarino (1999), focused on the processes by which these relationships develop and, more importantly, on how they are linked to firm performance. They say that CEO charisma works through both "close" and "distant" relationships. The CEO's charismatic behaviors increase team cohesion within the top management team, with whom the CEO is closely and directly involved, when the environment is uncertain. This cohesion then results in increased role modeling of charismatic behaviors at lower levels of management, heightening intragroup and intergroup cohesion and effort at lower levels. CEO symbolic behaviors, vision, and story telling also increase cohesion and effort at lower levels when there is perceived environmental uncertainty. The increased cohesion and

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