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The missing link? Investigating organizational identity strength and transformational leadership climate as mechanisms that connect CEO charisma with firm performance[☆]

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ABSTRACT

In this paper, we suggest that CEO charisma is related to firm performance via its effect on two important mediators. First, charismatic CEOs are expected to raise the transformational leadership climate within an organization. Second, both CEO charisma and transformational leadership climate are proposed to increase a firm's organizational identity strength (OIDS), which in turn, relates positively to firm performance. We tested these propositions on a sample of 150 German companies (20,639 employees) with a three-path mediation model at the organizational level of analysis, utilizing four independent data sources. Our study helps open the black box of organizational leadership and organizational performance by demonstrating top-level leadership's (CEO charisma) cascading effect on the TFL climate throughout the organization and by showing that OIDS mediates both leadership levels' relationships with firm performance. Further, our study is the first to investigate the relationship between OIDS and performance at the organizational level of analysis.

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Introduction

In this paper, we seek to integrate two central bodies of knowledge – the literature on organizational leadership and the literature on organizational identity – in order to contribute to the understanding of a controversial issue in organizational studies – the relationship between strategic or top-level leadership and organizational performance (Finkelstein & Hambrick, 1996). Earlier studies on this relationship focused on the effects of leadership succession on organizational performance and their conclusions ranged from reporting no effects (Lieberson & O'Connor, 1972) to “executive leadership can explain as much as 45% of organizational performance” (Day & Lord, 1988, p. 453). More recent studies have mainly focused on the relationship between charismatic or transformational leadership at different organizational levels and performance. Studies of transformational leadership generally support the existence of a relationship between TFL and individual and unit-level performance (for meta-analyses see Judge & Piccolo, 2004; Lowe, Kroeck, & Sivasubramaniam, 1996). However, very few studies examined this relationship at the organizational level.

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Studies on the relationship between CEO charisma and organizational performance have produced mixed results. Some studies report that CEO charisma has a positive effect on firm performance (Agle, 1993; Agle & Sonnenfeld, 1994; Waldman, Javidan, & Varella, 2004), while others report no effects (Agle, Nagarajan, Sonnenfeld, & Srinivasan, 2006; Tosi, Misangyi, Fanelli, Waldman, & Yammarino, 2004). One study reports a positive effect, but only under conditions of high environmental uncertainty (Waldman, Ramirez, House, & Puranam, 2001). A conclusion emerging from these findings (Agle et al., 2006; Waldman & Yammarino, 1999) is the need to better explain the inconclusive evidence of the relationship between CEO charisma and firm performance by studying the underlying processes that translate top-level leadership behavior into performance.

In this study, we develop and test a model that includes two potential mediators. The aim is to examine the possibility that even though CEO charisma may not have a direct relationship with firm performance, it may affect other variables, which in turn affect firm performance. First, we draw on the leadership literature and the organizational identity literature to suggest that CEO charisma affects the strength of the organizational identity, which in turn enhances firm performance. Voss, Cable, and Voss (2006) were among the first to empirically show that strategic or top-level leaders impact firm performance through organizational identity-related processes. If organizations and their management cannot project a solid and unified identity for employees to follow, their performance seems to suffer due to the lack of a common point of reference (Brown & Starkey, 2000; Scott & Lane, 2000). As “entrepreneurs of identity”, leaders play an important role in this regard (Reicher, Haslam, & Hopkins, 2005; Reicher & Hopkins, 2001, 2003). By engaging in rhetorical and symbolic behaviors, leaders create a strong sense of identity in their organizations. They use this identity “to persuade people to understand themselves, their interests, and their predicaments in a certain way, to persuade certain people that they are (for certain purposes) ‘identical’ with one another and at the same time different from others, and to organize and justify collective action along certain lines” (Brubaker & Cooper, 2000, p. 5). Based on the self-concept theory of charismatic leadership (Kark, Shamir, & Chen, 2003; Shamir, House, & Arthur, 1993), we suggest that charismatic CEOs are particularly likely to engage in behaviors that facilitate the development of a strong and shared sense of identity in their organizations. Hence, the stronger the CEO charisma, the more pronounced should be the organizational identity strength.

In addition, we propose a second path through which CEO charisma is associated with firm performance. As organizations increase in size, CEO charisma becomes a more distant form of leadership (Shamir, 1995), which has to be mediated by leadership at lower levels of the organization. The lower-level leaders have to transmit the charismatic leader’s vision to the organization’s lower echelons and demonstrate their commitment to the vision in their daily interactions with other organizational members. In other words, both the organization’s top-level and lower-level leaders may influence OIDS. We build on arguments and findings on the “cascading” effects of charismatic and transformational leadership (Bass, Waldman, Avolio, & Bebb, 1987; Waldman & Yammarino, 1999; Yammarino, 1994) to propose that the stronger the leader charisma, the more likely s/he is to foster a TFL climate in the organization. We further build on the literature on TFL across levels of analysis (Hill, Seo, Kang, & Taylor, 2012), as well as on recent studies on TFL climate’s effects on positive organizational outcomes (Menges, Walter, Vogel, & Bruch, 2011; Walter & Bruch, 2010), to propose that such a climate would further enhance OIDS and, ultimately, firm performance.

The model we more fully develop in the next sections is presented in Fig. 1.

Our study contributes to several streams of research. First, we enrich and refine the literature on the relationship between CEO charisma and firm performance by demonstrating two mechanisms that mediate this relationship. Second, we find support for arguments (to date only supported by a single study: Bass et al., 1987) regarding the relationship between an organization’s top-level and lower-level leadership. Third, we contribute to the emerging literature that views leadership as an organizational-level phenomenon and captures this view in the construct of leadership climate. Fourth, by positioning OIDS as a central and potentially useful mediator, and by showing its relationships with leadership aspects and firm performance for the first time, we make an original contribution to the organizational identity literature.

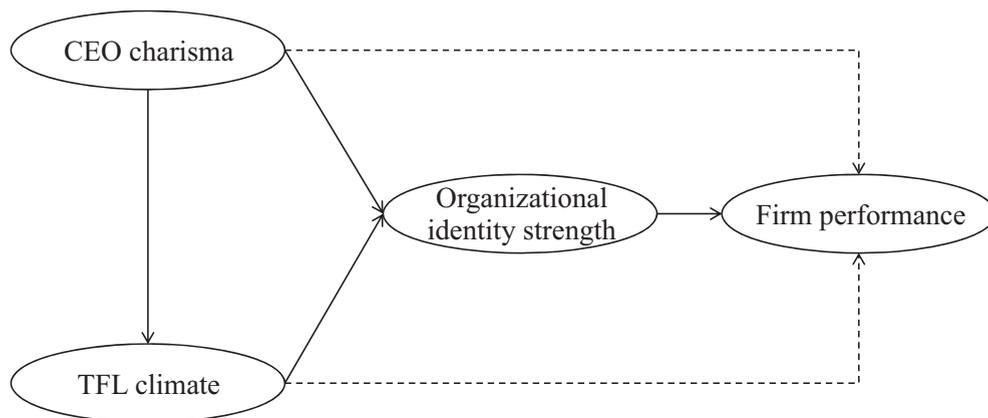


Fig. 1. Conceptual organizational-level model of the mediating role of identity strength in the leadership–performance link.
Note. CEO = chief executive officer; TFL = transformational leadership.

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