Are Dominant CEOs the Saviors of Troubled Firms?

Jianyun Tang, Mary Crossan

This study examines the appointment of dominant CEOs for troubled (i.e., poorly performing) firms and its implications for firm strategy and performance. With a sample of firms from the U.S. computer hardware and software industries that experienced CEO succession during the period 1994–2001, we found that troubled firms were more likely to appoint dominant CEOs than non-troubled firms. Newly appointed dominant CEOs undertook less strategic change than non-dominant CEOs in troubled situations, but undertook more strategic change in non-troubled situations. However, they performed no better than non-dominant CEOs with regard to post-succession firm performance whether in troubled or non-troubled situations. The results suggest that a heroic portrait of dominant CEOs in troubled situations might have impacted the practice of CEO appointment, but it appears to be a myth lacking a solid empirical basis.

Introduction

Strategic leadership research has long been interested in what kinds of leadership are needed for firm success and, particularly, what kinds of leadership are needed to rescue troubled firms. It is often viewed that troubled situations call for CEOs who can make tough (e.g., fast, unilateral) decisions (Whitney, 1987) and inspire confidence among key stakeholders (Arogyaswamy et al., 1995), and that dominant CEOs, defined as CEOs with dominant power relative to other executives in the top management team (TMT) (Eisenhardt and Bourgeois, 1988; Haleblian and Finkelstein, 1993), are more apt to do so than non-dominant ones (Whitney, 1987). Indeed, some legendary rescue successes (e.g., IBM by Louis Gerstner and Apple by Steve Jobs) seemed to have been led by dominant CEOs. While these CEOs are probably also known for their personality, charisma, and leadership style, power seemed a key factor in their success.

However, are dominant CEOs really the saviors of troubled firms? On the one hand, researchers are well aware of the attribution bias that tends to exaggerate a CEO’s role in corporate successes and failures (Bligh et al., 2011; Hayward et al., 2004; Meindl et al., 1985). Indeed, the academic literature has, overall, been rather pessimistic about dominant CEOs, arguing that they tend to increase politics and restrict information flow within the TMT and thereby negatively affect strategic decision making and thus firm performance (Eisenhardt and Bourgeois, 1988; Haleblian and Finkelstein, 1993; Priem et al., 1999). On the other hand, a heroic portrait of dominant CEOs has long existed (Whitney, 1987) and been rather resilient despite the skepticism and contrary evidence shown by many researchers (e.g., Khurana, 2002). To reconcile the pessimistic and heroic portraits, a recent study found that dominant CEOs tend to bring to their firms deviant strategy (i.e., a strategy deviant from the industry norms) and thus extreme performance — either big wins or big losses (Tang et al., 2011).

Notwithstanding the extensive research on dominant CEOs, the literature has remained largely silent on their effect in troubled situations. As the leadership quality required might differ significantly between troubled and non-troubled situations (Chen and Hambrick, 2012; Kanter, 2003), the effect of dominant CEOs might differ as well. Even though dominant CEOs might not have a positive effect on firm performance in non-troubled situations (Eisenhardt and Bourgeois, 1988; Haleblian and Finkelstein, 1993; Priem et al., 1999), the effect could be positive in troubled situations. This possibility warrants systematic examination given the theoretical and practical importance of rescuing troubled firms and the resilience of the heroic portrait of dominant CEOs especially in troubled situations.

Thus, in this study we examine the appointment of dominant CEOs in troubled situations and its implications for firm strategy and performance. We do so in the context of CEO succession because dominant CEOs might have a more salient effect when newly appointed to troubled firms and because the heroic portrait of dominant CEOs has its prototypical empirical root in the form of such newly appointed CEOs successfully rescuing the firms (Khurana, 2002; Whitney, 1987).

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Theory and hypotheses

CEO dominance

CEO dominance is defined as the power of the CEO relative to other executives in the TMT (Eisenhardt and Bourgeois, 1988; Halebian and Finkelstein, 1993). Power is “the capacity of individual actors to exert their will” (Finkelstein, 1992, p. 506) and is essentially “a property of social relationship, not an attribute of the actor” (Pettigrew, 1973, p. 26). We distinguish between CEO power relative to other executives and CEO power relative to the board. While these two constructs are positively related—that is, a CEO powerful relative to other executives is likely also powerful relative to the board (Tang et al., 2011)—they capture two different power relationships and thus affect different interpersonal and team dynamics. CEO power relative to other executives directly affects TMT dynamics and strategic decision making and is more applicable when the research focus is organizational outcomes such as firm strategy and performance. By contrast, CEO power relative to the board directly affects the interaction between the CEO and the board, and is more applicable when the research focus is the similarity of newly appointed directors or CEO with the board or the CEO (Westphal and Zajac, 1995; Zhu and Chen, 2015). In this study we focus on CEO power relative to other executives given our focus on the implications of appointing dominant CEOs for firm strategy and performance. In addition, in the CEO succession context, which we focus on in this study, CEO power relative to the board is less subject to the board’s choice or its negotiation with the successor CEO. For newly appointed CEOs, many factors typically used to capture CEO power relative to the board (e.g., proportion of inside directors, shareholding of outside directors, and CEO tenure)—except for CEO duality—are given and not subject to negotiation.

What differentiates dominant CEOs from non-dominant ones is “their capacity to make unilateral decisions despite other executives’ significant disagreements” (Tang et al., 2011, p. 1481). In other words, dominant CEOs have higher managerial discretion (Crossland and Chen, 2013; Hambrick and Finkelstein, 1987) and are more apt to make tough decisions. Although the label of dominance has been employed to describe not only power but also personality and behavior (Maslow, 1937; Pratto et al., 1994), it is used to describe power only in this study for two reasons. First, this usage is consistent with the upper echelons literature, in which CEO dominance is an established construct defined based on power (Eisenhardt and Bourgeois, 1988; Finkelstein et al., 2009; Halebian and Finkelstein, 1993). Second, for enabling tough decisions, power is arguably more crucial than dominant personality or behavior, the latter of which tends to be effectively exhibited only when the actor has sufficient power (Keltner et al., 2003). For example, although such personality concepts as charisma (Fanelli et al., 2009; Khurana, 2002), narcissism (Chatterjee and Hambrick, 2007), and hubris (Hayward and Hambrick, 1997; Li and Tang, 2010) have been suggested as factors enabling tough decisions, power is a more fundamental factor. Regardless of the CEOs’ personal traits, they would have difficulty making tough decisions if they have only limited power relative to other executives in the TMT (Tang et al., 2011).

CEO dominance may be affected by various factors such as the CEO’s track record, tenure (Hambrick and Fukutomi, 1991; Ocasio, 1994), and personality (House, 1988; Keltner et al., 2003); it may vary not only between CEOs but also across a CEO’s tenure. In the CEO succession context, the board has an especially important impact on the power of the successor CEO relative to other executives in the TMT (i.e., successor CEO dominance). The board may not only decide who is hired but also, through negotiating with the incoming CEO about his or her arrangements in the firm (e.g., titles, compensation, shareholding, and ability to restructure the TMT), directly affect the power relationship between the successor CEO and other executives in the TMT (Khurana, 2002; Westphal and Fredrickson, 2001). A key factor affecting the board’s consideration is firm performance at the time of succession.

Appointment of dominant CEOs

For troubled firms, boards need to decide whether they should stick with the incumbent CEO or hire a new CEO. Although there is no solid empirical basis, many believe that a change of leadership provides the best chance of success (Finkelstein et al., 2009). While incumbent CEOs supposedly have better knowledge of the firm (Virany et al., 1992), they are often implicated in the performance decline and may have lost credibility with key stakeholders, thus making it difficult to implement the required changes (Hofer, 1980; Kanter, 2003).

Not only do boards of troubled firms tend to remove the incumbent CEOs, they also tend to seek particular types of new CEOs, especially executives who are charismatic (Khurana, 2002) or a star (Graffin et al., 2011). An underlying common denominator of such executives is that they tend to have dominant power in their current position and would demand such power in their new position. Oftentimes, the boards of troubled firms tend to give the new CEO such dominant power relative to other executives in the TMT. First, the board might hold, as the new CEO might, a heroic portrait of dominant CEOs, believing that dominant power is necessary for the new CEO to make tough decisions and inspire confidence among key stakeholders and thus effectively reverse the troubled situation (Kanter, 2003; Whitney, 1987). Second, the board might end
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