# Rice study shows why more than 25 percent of new CEOs last less than 3 years

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An increasing number of CEOs are exiting their positions prematurely, according to a study by Yan Zhang at Rice University's Jones Graduate School of Management. Of the 204 company leaders Zhang studied from 1993 to 1998, 55 (27 percent) left their job within three years.

Zhang's study, "Information Asymmetry and the Dismissal of Newly Appointed CEOs: An Empirical Investigation," finds that these dismissals may be due to the effects of information asymmetry -- a situation where one party knows less inside information than the other. In the instance of CEO selection, the board of directors of the hiring firm knows less than the CEO candidates regarding the candidates' true competencies. As a result, it is possible that the board makes a faulty hire and then dismisses the CEO shortly after the succession.

Unbalanced information can negatively impact the selection of a new chief executive in three ways. The first concerns the origin of the new CEO — whether he or she was an internal or external candidate. The second is the context of the preceding CEO's departure — whether it was a voluntary departure or a dismissal. And the third is the composition of the board of directors' nominating committee — whether they are primarily in-house or independent directors and whether they serve on a number of other boards.

The origin of the new CEO is important because inside candidates are typically already chief financial officers, chief operating officers or executive vice presidents with the company, said Zhang, associate professor of management at Rice.

"They would have had numerous opportunities to interact with the board members," Zhang said. "The board has a great opportunity to know inside candidates, thus reducing information asymmetry between the board and inside candidates."

Meanwhile, the board is less likely to know outside candidates and more likely to make a poor hiring decision in outside successions.

The conditions of the preceding CEO's departure also play a tremendous role in the success of the next chief executive, Zhang said. Because many companies institute mandatory retirement ages, planned succession can help ease a seamless transition, as a company can groom an heir apparent before the CEO departs. Also, if the company doesn't have a good pipeline of talent, the board can search in advance of the retirement -- making it more likely that a comprehensive internal and external search will turn up higher-quality candidates. However, if the preceding CEO is dismissed, then inadequate preparation means higher information asymmetry and a higher likelihood that the board will make a poor hiring decision.

The composition of the board's nominating committee may have an influential effect on early CEO dismissals. Nominating committees that are primarily independent (not consisting of company executives) are better than those with internal directors, because the latter may perceive themselves as contenders for the position.

"They're not going to bring objective evaluations to the CEO selection process," Zhang said. "However, if a company has outside directors on the board and those outside directors are too busy — having too many other directorships — then the nominating committee is not as effective."

Source: Rice University