

# CEOs hired from outside a firm are more likely to be dismissed

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A new study in *Strategic Management Journal* reveals that Boards of Directors commonly make mistakes in CEO appointments when they hire CEOs from outside the firm. The Board knows less than the external CEO candidates regarding their true competencies, and as a result Boards often make faulty hires when they seek new leadership outside the firm. Boards can help avoid the problem of short-tenured external appointments -- although not eliminate it -- if they create nominating committees with leadership by outside directors, who tend to have broader perspectives on the skills of potential candidates.

Yan Zhang of Rice University reviewed data on 204 newly appointed CEOs (defined as those with tenure of three years or less) in the United States and studied rates of dismissal, controlling for alternative explanations such as firm performance and political factors.

The study found that Board of Directors often make poor CEO selection decisions due to the absence of adequate information. The candidates typically possess more information about their true competencies than the Board. This makes it difficult for the board to select a new outside CEO whose skills fit the firms' needs. By contrast, although even inside candidates may fail, boards have better information about the true skills and potential fit of inside promotions. Thus, inside CEOs are less likely to be dismissed with a short tenure than outside CEOs.

The study highlights several factors that increase the chance that a newly appointed CEO will be dismissed or will succeed. One major influence

on failure arises from the fate of the predecessor CEO. In particular, failure tends to breed failure, such that the dismissal of the predecessor CEO substantially increases the likelihood that a newly appointed CEO will be dismissed. By contrast, firms that create nominating committees that are led by outside directors are more likely to identify candidates who succeed in their new jobs.

Source: Wiley

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