Outside CEOs could rejuvenate struggling businesses

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Studying firms over 60 years, Ferris and his research team found that when a company hires a CEO from outside the company, it is a signal that the company is getting ready to make significant changes. Credit: University of Missouri

CEOs hired from outside a company tend to spend more money on research and development, while CEOs hired from within are likely to make large, strategic acquisitions, new research from the University of Missouri has found. According to the six-decade study, while 78 percent of new CEOs are selected from within the organization, internally and externally chosen CEOs execute different financial strategies that could be best-suited for companies with different needs.

"If a company currently is either mired in mediocrity or performing poorly and it announces the hiring of an external CEO, it could be a signal that the board is serious about fixing problems," said Stephen Ferris, professor and director of the Financial Research Institute at the MU Trulaske College of Business. "Although we cannot foretell the outcome of hiring an external CEO, or any new CEO, it could give investors reason to think about investing a little more confidently in that company within the context of their portfolios. The hiring of an internal candidate, on the other hand, may indicate that a company is stable and likely to continue an already successful business approach."

Ferris, along with researchers from the Georgia Institute of Technology and California State University at Fullerton, studied succession patterns of the 2,524 CEO turnovers from all firms on the Standard & Poor's 500 Index during the years 1951-2010. Researchers analyzed business decisions of new CEOs and found that external hires spend more money on research and development, which Ferris said is indicative of commitment to innovation. The study also showed that while internal hires make fewer merger offers than their external counterparts, the acquisitions they do make are much larger in size and more frequently purchased using stock rather than cash.

"If a firm is doing well, the internal process frequently will be sufficient to identify, nurture and promote the people who ultimately will be able to lead the company and continue to generate value," Ferris said. "If not,

companies start looking externally, and though it may create uncertainty, it takes a certain amount of honesty and humility to say that you don't have anyone internally you feel can run the company. The move to select an external CEO often speaks to the strength of character and foresight of these firms—and of American capitalism in general, given that one out of every five new CEO positions goes to an external candidate."

Ferris said that because external and internal CEOs make different strategic and financial decisions and tend to be hired under different circumstances, both internal and external hires can be positive moves depending on companies' needs.

"We found that internal CEOs have been the consistent choice for corporations over time, a trend that persisted even through major political and economic changes," said Ferris. "However, we found that forced turnover drastically increased the likelihood of external selections, and that external CEOs tend to make different business decisions than do internal candidates. Change clearly is needed in those situations, so it makes sense to look outside the company for someone to rejuvenate the firm."

Ferris' study, "Six Decades of CEO Successions: The Importance of Being an Insider," will be published in an upcoming issue of the *Journal of Accounting and Finance*.

Provided by University of Missouri-Columbia

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