Study examines how CEO power affects companies in times of crisis

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A new study from UT Dallas finds that bestowing considerable power in the CEO does not create value for the firm during industrywide downturns.

"We wanted to look at crisis situations in which urgency—the speed of making a decision—could potentially be really important," said Dr. Vikram Nanda, O.P. Jindal Distinguished Chair in Finance in the Naveen Jindal School of Management and one of the paper's authors. "We look at severe industry downturns. The essential idea is, when you have concentrated power in the hands of the CEO or a small group of decision-makers, does that lead to better decision-making or worse?"

The study, "When Crisis Knocks, Call a Powerful CEO (or Not)," recently was published online in *Group & Organization Management*.

Nanda said the topic of CEO power—the concentration of decision-making authority in the chief executive—has long been a topic of interest for organizational scholars and manager practitioners. Agency theory says CEO power is ultimately detrimental to the company, while strategic leadership literature highlights the instrumental role the CEO plays in getting things done.

Using information on large publicly traded firms from Standard & Poor's, stock price information and databases on boards of directors, the researchers sampled 3,724 CEOs in 2,097 companies during the time period of 1992 to 2009. CEO power was determined by answering

questions such as, "Is the CEO also the chairman of the board?" and "How much does the CEO make in comparison to the firms' other top executives?"

For innovative firms with powerful CEOs, an industry downturn results in a notable decrease in the firm's value, or book-to-market ratio, relative to a less powerful CEO, the study found. For firms with powerful CEOs in competitive industries and high-discretion industries, a downturn results in a decrease in firm value.

In general, a small concentration of power does not work well, even in times of crisis, Nanda said. It's a trade-off, he said. Decisions may be made faster because only one or two people need to weigh in, but it could be detrimental if the CEO does not get input from other sources.

Instead, companies should keep their information channels open, Nanda said. The search for more information should not be sacrificed by urgency, he said.

CEO governance is an important issue, Nanda said. Regulatory response has been to increase the power of the board or make the board independent of the CEO. Although there is some skepticism about the benefits of intervention, such as independent audit committees, on average, these regulations have helped, Nanda said.

"CEOs can actually benefit from having a board of independent members, or having different voices in the boardroom," Nanda said. "That can lead to better decision-making. It would be positive for the firm to view it from that perspective. Many of them do, but there are always people who want more power and more authority, and don't want to have people looking over their shoulder. On the other hand, that may be what helps a firm deal with a crisis."

More information: V. K. Gupta et al. When Crisis Knocks, Call a Powerful CEO (or Not): Investigating the Contingent Link Between CEO Power and Firm Performance During Industry Turmoil, *Group & Organization Management* (2016). DOI: 10.1177/1059601116671603

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