

Why CEOs of failing companies jump ship... or don't

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The UA's Han Jiang and his colleagues explored what influences CEOs' decisions to stay or go when business is bad. Credit: University of Arizona

It's a common scenario in the corporate world. A company begins to fail, and before long the CEO is out the door. Sometimes the person is asked to go, but other times it's a voluntary move—a decision that may be driven largely by the executive's so-called "social capital," according to a new study led by the University of Arizona.

Researchers found that CEOs who have strong social capital—or personal relationships with business colleagues and key external stakeholders—are less likely to jump ship if their companies begin to fail. Yet, at the same time, executives with very low social capital may be just as likely to stick around during difficult times, albeit for different reasons. In the end, it's the executives whose social capital falls somewhere in the middle who are most likely to quit when the going gets tough, according to the study, which is published in the *Strategic Management Journal*.

Lead researcher Han Jiang, an assistant professor of management and organizations in the UA's Eller College of Management, approached the question of what motivates CEOs to jump ship from a network embeddedness perspective, which argues that people's decisions are strongly affected by their social ties and the networks in which they participate.

A CEO's decision to stay or go is ultimately a cost-benefit dilemma, Jiang explained. If a company fails on an executive's watch, his or her reputation could suffer, and he or she may become less valuable in the labor market as a result. That alone could be powerful enough motivation to jump ship. However, if a CEO chooses to leave, he or she could in turn be sacrificing access to valuable company resources and connections.

Jiang and his collaborators found that when CEOs have low social capital, or limited professional networks, they indeed may wish to leave their failing firms in order to protect their reputations, but because of their minimal connections, quitting often is not a viable option.

"If I don't have strong enough social capital and I don't know anybody in this business circle, even if I want to escape from my declining firm, I probably won't be able to find opportunities that will allow me to do so,"

Jiang said. "I probably will be locked up in my company, so I have no choice but to stay."

On the flip side, while CEOs who have very strong social capital could potentially leverage their connections to find employment elsewhere, they, too, are unlikely to leave, precisely because of how well-connected they are.

"If my social capital is strong enough, I probably won't be that worried or concerned about the negative consequences of my company failing. Even if my firm does end up failing, I can still manage to leverage my strong connections to find myself a parachute that will allow me to land safely after that failure," Jiang said. "More importantly, if I have very strong social capital, I'm probably more confident about using my capability and my resources to save my firm."

The social capital of a CEO's colleagues also may factor into an executive's decision, Jiang said.

"If my peers have very strong social networks, I'll probably be very hesitant to leave," Jiang said. "If I just abandon everyone, and they have very strong social networks, they may leverage their networks to trash me. Even worse, they may make me the scapegoat. They might use their social network to send out a message blaming me as the one responsible for the decline."

Executives with moderate social capital are the most likely to voluntarily step down from the helm of a failing company, Jiang said.

"If I have a medium level of social capital, I can leverage my fairly established social network to find myself alternative employment opportunities," he said. "Compared to extremely socially connected executives, I'm probably not that confident about being able to save my

firm, and I probably won't be that protected from the consequences of a potential public failure. I have both the motivation and the capability to leave."

The researchers' findings were based on an analysis of the social capital and voluntary job movements of 278 executives of declining firms in China, where publicly traded companies that report two consecutive years of loss are labeled on the Chinese stock market as "special treatment" to alert traders to their declining performance and high-risk nature.

Jiang and his collaborators controlled for factors such as CEOs' age, education, gender, compensation, executive shareholding and tenure in their current positions.

While much of the literature on CEO turnover has focused on involuntary departures, or firings, fewer studies have looked at what motivates CEOs of failing companies to voluntarily leave their posts, said Jiang, who became interested in the topic while working as a consultant in China.

"We are among the few research efforts that specifically highlight the potential decision mechanisms behind voluntary executive turnover," Jiang said. "This can provide us some fresh insight that will allow us to examine the operation of declining firms. For example, with our findings we can probably predict who will choose to stay in these declining firms. Practitioners may also be able to identify those who stayed but should have left in order to increase the effectiveness of turnaround efforts of these declining firms."

While the data used in the study was from China, Jiang expects the findings to hold true across cultures and also industries, although the magnitude of social capital's effect could vary—for example, between

countries such as China that place high value on social networking versus countries driven more by individualism.

Despite those potential differences in effect size, Jiang said, the general story is expected to remain the same: "Your [social capital](#) determines both the opportunity to voluntarily leave your employer and the potential costs of doing so."

More information: Han Jiang et al. Choose to fight or choose to flee? A network embeddedness perspective of executive ship jumping in declining firms, *Strategic Management Journal* (2017). [DOI: 10.1002/smj.2637](#)

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