Stakeholders' sentiment can make or break a new CEO

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When a CEO steps down or is dismissed, the attention of the board is on how to choose the right executive to succeed that CEO. However, Bocconi University professor Dovev Lavie claims that managing the process of introducing the new CEO and choking the negative sentiment that can arise among stakeholders in a moment of uncertainty could be a more critical task, especially when the new CEO comes from outside the firm.

The effect of such a negative sentiment, which is a form of psychological bias, on a firm's performance is stronger than the implications of the new CEO's previous experience and fit between the CEO's corporate background and the appointing firm's characteristics.

Professor Lavie and co-authors Thomas Keil (University of Zurich) and Stevo Pavićević (Frankfurt School of Finance and Management), in a paper in-press on the *Academy of Management Journal*, investigate the link between the appointment of an outside CEO and a firm's performance. The appointment of outside CEOs has become increasingly common in recent years, with about a third of appointed CEOs originating from outside the firm. Yet most studies report that they underperform compared to inside CEOs and exhibit greater performance variability.

Analyzing 1,275 appointments in 882 publicly listed US firms during 2001-2014, the study refines existing CEO-centric theories on the effect of a CEO's previous experience and fit, while introducing a novel stakeholder-centric perspective, which relates post-succession performance to the sentiment of stakeholders toward CEO appointments.

"Our findings reveal that, counter to expectations, the length and breadth of a CEO's executive experience do not enhance firm performance, nor explain the performance differences between inside and outside CEOs," Professor Lavie says. "Rather, the misfit between the CEO's corporate background and the appointing firm's characteristics, in terms of industry, firm size and firm age, undermines firm performance, especially following outside CEO appointments."

More importantly, the authors contend that negative sentiment originating from the firm's stakeholders toward the appointment of the CEO may hamper a new CEO's effectiveness, and hence firm performance.

They capture stakeholder sentiment using textual analysis of 27,092 press items around the announcement of CEO successions and further study the reactions of relevant stakeholders, such as analysts' buy/sell recommendations, executives' sales of their firm's stocks, and employees' ratings of their new CEOs.

Negative sentiment turns out to undermine post-succession performance and this effect is more significant than that of corporate misfit. Negative sentiment, if left unattended, can escalate, leading to increased scrutiny, deprived support, organizational resistance, and reputational damage.

Both inside and outside CEOs can suffer negative sentiment, but the effects are stronger for outside CEOs because they are less familiar with the hiring firm and cannot readily use workplace politics and personal networks to muffle them. The study finds that outside CEOs have an advantage so long as their corporate background makes a good fit with the hiring firm and the negative sentiment is effectively dealt with.

"Boards should develop practices that enable outside CEOs to quickly integrate into the firm and its social networks, while carefully and promptly managing the reactions of all stakeholders. For their part, newly appointed CEOs should consider tactics for offsetting negative sentiment before it escalates, e.g., by restructuring the top management team, leveraging public relations, or building social ties in the firm prior to taking office," the authors suggest.

More information: Thomas Keil et al, When Do Outside CEOs Underperform? From a CEO-Centric to a Stakeholder-Centric

Perspective of Post-Succession Performance, *Academy of Management Journal* (2021). DOI: 10.5465/amj.2018.1087

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