Research finds how much CEOs matter to firm performance

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"Do CEOs matter?" has been a perennial question in management discourse. But "the CEO effect" has been notoriously difficult to isolate—a moving target caught in the slipstream of dynamic forces that shape firm performance.

So Morten Bennedsen, INSEAD Professor of Economics and the André and Rosalie Hoffmann Chaired Professor of Family Enterprise, along with colleagues Francisco Perez-Gonzalez (ITAM and NBER) and Daniel Wolfenzon (Columbia University and NBER) decided to find out how much CEOs matter by measuring the impact on firm performance when a CEO is absent, specifically, hospitalised.

They find, in a forthcoming paper, "Do CEOs Matter? Evidence from Hospitalization Events," soon to be published in the *Journal of Finance*, that the financial ramifications of CEO hospitalisation are significant.

Based on data of nearly 13,000 Danish SMEs between 1996 and 2012, Bennedsen and his co-authors find that five-to-seven day hospitalisations sent firm profitability tumbling by 7% in the year of illness. Longer hospital stays of 10 days or more wreaked even deeper damage, lowering operating return on assets (OROA) by a full percentage point.

Given that the average age of today's CEOs is between 57 and 60 (depending on the industry), hospitalization is also a sadly plausible possibility—especially so in light of the ongoing coronavirus epidemic, which is spreading rapidly and even infecting senior government officials and celebrities.

Compared to hospitalisations involving senior managers subordinate to the CEO, chief executive hospitalisations cost firms more than twice as much.

In exploring hospitalisations, their purpose was to gain more clarity on "the CEO effect"—i.e. the portion of firm-level performance directly attributable to the chief executive., but a proxy effect stemming from industry differences or even blind luck cannot be discounted.

Focusing on hospitalization enabled the study authors to gauge the CEO

effect by comparing an organisation's performance during the year of the CEO's illness to that of past years under the same CEO.

To ensure the noted effects genuinely derived from the temporary loss of the CEO, the authors controlled for various other factors, including turnover among senior managers, prior health scares from the same CEO which might boost organizational preparedness, and firm performance prior to the CEO's hospitalization. None of these yielded statistically significant results, suggesting it was indeed the CEO's absence that caused the pronounced dip in performance.

However, the degree of the dip varied depending on a number of attributes. It was greater in the case of younger, better-educated and more experienced CEOs, as well as for organisations with above-average power concentration at the top of the hierarchy. Additionally, firms within rapidly expanding and human capital intensive industries—which demand more management skill—took especially heavy hits when a CEO was admitted to hospital.

Bennedsen says, "These results provide suggestive evidence of the setting in which CEO succession and contingency plans may have the most meaningful effect on performance... In addition, they point to the possibility of CEO absence as a neglected area of risk exposure, which HR managers should perhaps be aware of so they can effectively intervene if need be."

More information: MORTEN BENNEDSEN et al. Do CEOs Matter? Evidence from Hospitalization Events, *The Journal of Finance* (2020). DOI: 10.1111/jofi.12897

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