CEO Performance in Severe Crises: The Role of Newcomers

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"The biggest trap that new leaders fall into is to believe that they will continue to be successful by doing what has made them successful in the past..." Michael Watkins

The optimal CEO: trade-offs

- Top executives **impact strategic choices and firm performance** in significant ways - especially during major crises
- Firm's face a **trade-off** when selecting a CEO:
  - A **newcomer** (a relatively recent external hire), who can turn things around, but who starts with a knowledge deficit
  - An **experienced insider**, who already masters the way business is usually done, but who can more easily fall prey to an 'experience trap'
- Firms choose their CEO along the tenure-origin locus, for given expectations about the future
- If unexpected circumstances materialize, such as a major crisis, the optimal mix of CEO characteristics will likely change

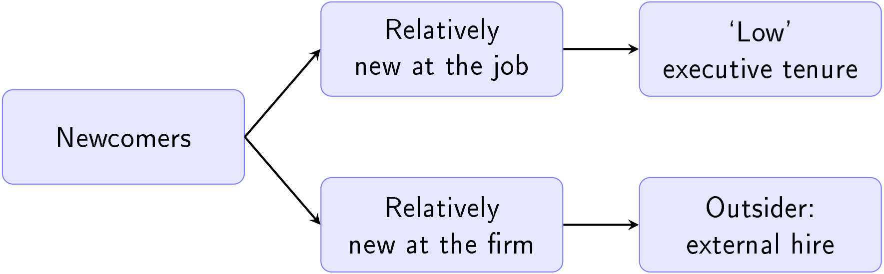
A severe economic crisis: the role of a newcomer

A severe economic crisis implies a drastic shock to the usual framework

- Risks of an experience trap increase and “business as usual” no longer applies
- Newcomer may respond more creatively to unexpected circumstances
  - Different experience
    - Less attached to the status quo
    - Recent experience from a different firm
  - Different incentives
    - Drive to prove competence
    - Higher net benefits due to longer expected horizon at the firm
  - More likely to take risks (Luo et al., 2013)

Newcomer CEOs

- Do newcomers outperform higher-tenured/inside CEOs during a crisis?



What does the literature say about CEO tenure?

Impact of CEO tenure on firm performance is described as an inverted U (Henderson et al.,2006; Wu et al., 2005; Luo et al.,2013):

- At first: CEOs learn rapidly, are willing to take risks, expand their experience and skill set, **improving firm performance**
- Fast-forward a decade: and the same CEO becomes risk-averse and slow to adapt to change, **hurting firm performance**

What does the literature say about outsiders?

- Struggling companies are more likely to hire outsiders (Parrino, 1997)
- Have become more prevalent and get paid more (Murphy et al., 2007)
- Shareholders react positively to the announcement of an outside CEO, in particular when change is needed (Borokhovich et al., 1996)
- **Research is inconclusive on whether outside CEOs perform better**
  - Bidwell (2011) and Zajac (1990) find that outsiders perform worse
  - Huson et al. (2004) find the opposite

Contribution to literature

- **Subject:** Estimating the value of newcomers to a firm hit by a crisis..
  - ..and evaluating how this changes from normal to crisis times
- **Method:** We use the recent economic crisis in Portugal to address the endogeneity problem
  - Exogenous unanticipated shock
  - Unprecedented dimension
  - Transversal to all firms

Are newcomers different? And the firms they run?

- **Dataset:** Quadros de Pessoal and IES
- **Sample:** Firms created before 2011, with no CEO turnover during or immediately before the crisis: 50718 firms, 63684 CEOs, 6 years, 225629 observations

	Newcomer	Non-newcomer	Difference	
CEO characteristics:				
CEO tenure	3.710	10.102	-6.392	***
CEO age	41.596	47.439	-5.844	***
CEO gender	0.294	0.264	0.030	***
Education	5.220	4.842	0.378	***
Firm characteristics:				
GVA	10.719	11.257	-0.539	***
Total sales	11.984	12.536	-0.552	***
Firm age	6.283	16.542	-10.259	***
No. of workers	6.528	11.092	-4.564	***
No. of establishments	1.157	1.247	-0.090	***

Table 1: Newcomer statistics: CEO and firm characteristics

Empirical framework: main specification

$$Ln(GVA)_{it} = c + \beta_1 \text{Crisis}_t + \beta_2 \text{Newcomer}_{it} + \beta_3 \text{Newcomer*Crisis}_{it} + \beta_4 \text{X}_{it} + \alpha_i + \varepsilon_{it}$$

- Ln(GVA)_{it} represents the log gross value added of each firm i, at time t
- Newcomer_{it} represents the treatment group: dummy equal to 1 for newcomers (recent external hires)
- X_{it} are observed time-varying characteristics
- α_i are firm unobserved time-invariant characteristics: firm heterogeneity
- ε_{it} is the error term

Newcomers and firm performance

	Firm Performance			
	Gross Value Added		Sales	
	OLS	Firm fixed effects	OLS	Firm fixed effects
	(1)	(2)	(3)	(4)
Crisis	-0.154***	-0.140***	-0.104***	-0.099***
	(0.011)	(0.016)	(0.013)	(0.013)
Newcomers	0.000	-0.033	0.046**	0.027
	(0.013)	(0.021)	(0.023)	(0.019)
Newcomers*crisis	0.161***	0.164***	0.135***	0.160***
	(0.017)	(0.022)	(0.022)	(0.020)
CEO age	0.001**	0.006	0.001	-0.008
	(0.001)	(0.006)	(0.001)	(0.006)
CEO gender	-0.005		-0.099***	
	(0.011)		(0.023)	
Education	0.020***	0.011	0.032***	0.005
	(0.003)	(0.010)	(0.006)	(0.006)
Firm age	-0.002***	-0.008**	-0.001	0.002
	(0.000)	(0.004)	(0.001)	(0.004)
No. of workers	0.266***	0.674***	0.356***	0.626***
	(0.017)	(0.026)	(0.026)	(0.025)
No. of establishments	-0.005***	0.002	-0.007*	0.002
	(0.001)	(0.003)	(0.004)	(0.002)
Average performance	0.799***		0.681***	
	(0.017)		(0.024)	
Observations	22,324	22,534	23,194	23,783

Table 2: Newcomers and firm performance: difference-in-differences

Newcomers: different thresholds for executive tenure

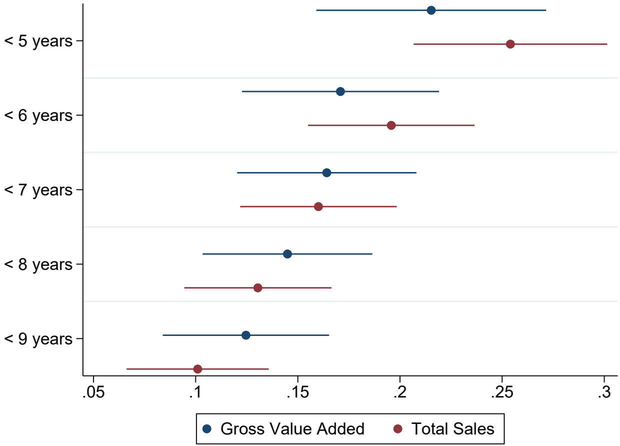


Figure 1: Newcomer's executive tenure and the performance premium

Note: The dots stand for the estimated coefficients and the lines represent the 95 per cent confidence interval.

Additional results

- **Results hold across different samples:** firms managed by a CEO (owner) present a performance gap of approximately 18 pp (24pp)

- **Propensity score matching:** matching based on observable pre-crisis firm and CEO characteristics confirm the robustness of previous findings, suggesting that the endogeneity of CEO selection is unlikely to drive our primary findings

- **Firm survival**: Firm's run by newcomers are more likely to stay in business during the crisis period

    - This result is particularly important to confirm that our previous findings are not driven by firm selection

Newcomers: what do they do differently?

- This preliminary analysis is suggestive, and not intended to uncover exactly what lies behind newcomers' success
- Our results suggest however that the differences in performance seem to map into different management practices

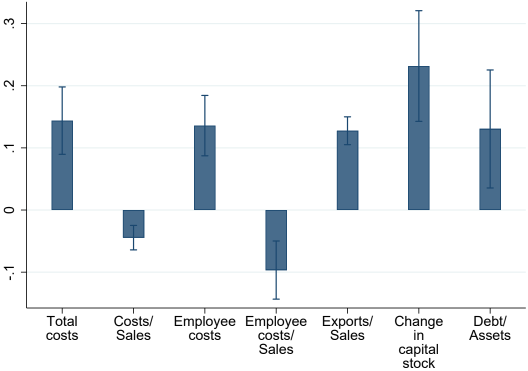


Figure 2: Newcomers and key instruments: propensity score match

Note: The bars represent the estimated coefficients and the lines the 95 per cent confidence interval.

Newcomers and firm productivity

- Management practices are also relevant for productivity, specially in times of uncertainty and crisis (Bloom and Van Reenen, 2010)
- Do newcomers also deliver higher productivity levels during the crisis?

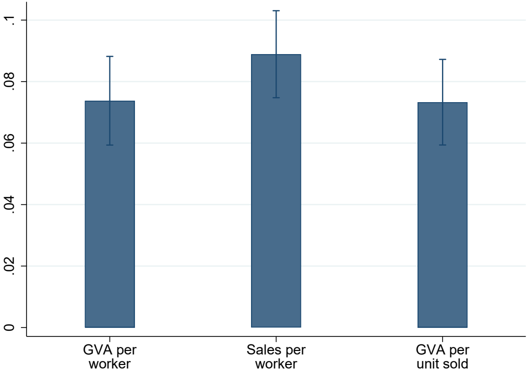


Figure 3: Newcomers and firm productivity: propensity score match

Note: The bars represent the estimated coefficients and the lines the 95 per cent confidence interval.

Some final remarks

- Newcomer CEOs deliver better firm performance, increase firm survivability and productivity, during a major exogenous crisis
- Non-observable differences which seem insignificant in normal times, can make a difference under exceptional circumstances
- Accumulated experience in the firm is not key in periods of economic distress
- Newcomers make different management choices as far as costs, employment, openness to foreign markets, financing and investment
- Future research should focus on deepening our analysis of the different management practices of newcomer CEOs

Thank You

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