THE INCREASING ABILITY OF CEOS TO EFFECT FIRM PERFORMANCE OVER TIME

The importance of managers has long been understood; however, little is known about how much managers matter in influencing firm outcomes. In recent decades, an increasing focus and importance has been placed on the role of the Chief Executive Officer (CEO). Some argue this focus is due to our cultures romanticization of leadership, while others suggest this focus reflects the changing realities and influence of the job of corporate executives. Recent research in the *Strategic Management Journal* demonstrates that over time CEOs have grown in their ability to influence their firm's performance, both positively and negatively, while the effects of the company itself and its industry on performance have decreased over time.

Key Takeaways:

- Chief Executive Officers (CEOs) have had an increasing ability to affect firm performance, positively or negatively, in more recent decades.
- While characteristics of firms and industry level effects still significantly influence firm performance, these effects are decreasing while CEO effects are increasing.

Researchers utilized data across 60 years (1950-2009) and 30 industries to examine the performance of 1015 companies and partition the variance over time in a firm's performance to effects based on year, industry membership, the company, and the company's CEO. Over time, the researchers illustrate that CEOs have an increasingly positive *and* negative effect on their company's return on sales (ROS), return on assets (ROA), and market-to-book ratio (MTB). The aggregate CEO effect is shown to increase from approximately 8 percent of variance in 1969 to close to 20 percent by 2009, suggesting a sharp increase in the ability of CEOs to influence firm performance. At the same time, the researchers note that the influences of industry and firm characteristics, related to factors outside of a current CEO, have decreased. These results do not suggest CEOs are more positively influencing their firms, but rather the decisions of individual CEOs have a greater influence on firm performance within their tenures in recent decades.

In summary, an increasing focus has been placed on the role of CEOs; however, this focus merely reflects a growing importance on the role of CEOs in influencing their firms in recent decades. In today's environment, this has important implications for CEO selection processes, as choosing the wrong CEO today can lead to significantly worse negative outcomes for companies than in the past, while choosing the right CEO can positively impact the company both in the present and for years to come.

Source: Quigley, T.J. & Hambrick, D.C. (2014). Has the "CEO Effect" Increased in Recent Decades? A New Explanation for the Great Rise in America's Attention to Corporate Leaders. *Strategic Management Journal*, 36: 821-830.

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