

A Risk-Taking Perspective on CEO Selection

Most research on CEO selection is focused on choosing between promoting from within and hiring from outside and aims to understand which leads to better performance. Forthcoming research in the *Strategic Management Journal* takes a different approach, assessing variability in performance as the outcome of interest. The researchers view CEO selection as a risk-taking decision, in which promoting a CEO from within the company is less risky, driving more conservative outcomes that mirror prior performance, and outside hires drive more extreme performance outcomes – both positive and negative. Their findings support the idea that outside CEOs produce more variable performance instead of better or worse outcomes.

Key Takeaways:

- CEO hiring decisions can be viewed as decisions about risk based on familiarity with candidates and their abilities.
- Hiring CEOs from outside the firm produces more extreme performance – both high and low – reflecting their risky nature.

The researchers identified two sources of risk in hiring an outside CEO. First, knowing what makes a successful CEO is difficult and sometimes firm-specific, making it unclear whether an outsider's prior success will transfer. Second, companies have more information about inside candidates, reducing the risk of promoting a CEO from within. In a sample of 1,027 succession events in S&P 1500 companies between 2006 and 2011, the researchers found that extreme

increases and extreme decreases in industry-adjusted return on assets were about equally likely for companies that had hired inside CEOs or outside CEOs - average performance was not higher for either group. However, 26% of companies that hired outside CEOs saw extreme performance changes (more than 6% up or down), compared to only about 21% of cases where inside CEOs were hired.

In summary, promoting CEOs from inside a company is more conservative than recruiting from the outside. The researchers were unable to observe whether inside and outside CEO hires behaved differently, made different choices, or faced different organizational constraints, any of which might account for more extreme performance outcomes after an outside CEO hire.

Source: Quigley, T. J., Hambrick, D. C., Misangyi, V. F., & Rizzi, G. A. (in press). CEO selection as risk-taking: A new vantage on the debate about the consequences of insiders versus outsiders. *Strategic Management Journal*. DOI: 10.1002/smj.3033.