

Escalating Board Commitment to Poorly-Performing CEO Hires

Research published in the *Strategic Management Journal* studied how boards respond when their firms perform poorly under CEOs that they hired in that role. The authors specifically examined whether boards with more directors who were present when the poorly-performing CEO was hired (referred to as “hiring directors”) have a more difficult time admitting the hiring decision was a mistake. As such, such boards would “escalate their commitment” to that CEO by retaining him/her longer and granting him/her more pay than boards with fewer hiring directors.

Key Takeaways:

- Directors who served on the board when a CEO was hired are more likely to remain committed to that CEO following poor firm performance.
- For every one hiring director remaining on the board, poorly performing CEOs are 25% more likely to be retained and receive a 25% higher change in pay.
- These effects are weaker for more experienced boards, indicating experience reduces the tendency to overcommit to their hand-picked CEOs.

The authors examined the change in CEO pay and likelihood of CEO dismissal for every S&P 500 company facing performance decline from 2005-2015. They found that each additional hiring director remaining on the board equated to a 25% higher change in CEO pay from the previous year and 25% decrease in likelihood of CEO dismissal. The authors did, however, find that these effects

were weaker for more experienced boards, indicating that overall experience helps dampens the effects of board members’ biases to overcommit to their hand-picked CEOs.

The authors supplemented this study with a detailed survey of 72 for-profit board directors, largely corroborating their findings. Of note, a clear majority of respondents thought that hiring directors are more lenient towards their CEOs, believing among other things that such directors “tend to be less objective”, “rationalize the company’s poor performance”, and ultimately “do not like to admit a mistake in hiring”. The authors hope to bring better awareness to the potential biases confronting boards in monitoring their CEOs and encourage more “robust dialogue” among directors to mitigate any natural tendencies to escalate commitment to their hired CEOs.

Source: Zorn M.L., DeGhetto K., Ketchen D.J., & Combs J.G. (2019). The impact of hiring directors' choice-supportive bias and escalation of commitment on CEO compensation and dismissal following poor performance: A multimethod study. *Strategic Management Journal*.