

CEO Personality and Market Perceptions

Logic from economics holds that higher risk brings higher rewards, but the returns to risk are not always the same. Forthcoming research in the *Academy of Management Journal* shows CEOs' personalities can influence market judgments to change the risk-reward equation and even turn it negative. Researchers examined how CEO personality traits shape the way the stock market assesses both the company's level of risk and the expected returns to risk taking.

Key Takeaways:

- CEOs display their personality traits through their choices of words and phrases in unscripted speech.
- Investors view firms as less risky when CEOs are high in conscientiousness, and low in both neuroticism and extraversion”
- Returns on risk are higher for firms whose CEOs display higher levels of conscientiousness, and low levels of neuroticism and extraversion.

Markets make use of all kinds of available information, so the researchers predicted CEO personality would change the way markets judge a firm's risk level, and how markets value risk-taking. Studying S&P1500 companies and their CEOs, the researchers connected stock risk and shareholder return to three core CEO personality traits – conscientiousness, neuroticism, and

extraversion. Transcripts from unscripted Q&A portions of conference calls were used to assess CEOs' personality traits, and stock market information to understand market reactions. Consistent with their predictions, investors treated firms as more risky when the CEO displayed lower levels of conscientiousness or higher levels of neuroticism or extraversion. A given level of risk brought higher returns to more conscientious, less neurotic, or less extraverted CEOs. Higher risk even led to lower returns when CEOs were especially low on conscientiousness or high on extraversion.

The researchers caution against selecting CEOs on the basis of extraversion, because extraverted CEOs may be no more effective than others but have the negative unintended consequences for markets seen in this study. They note that more research is needed to understand the role of impression management in shaping external judgments, and to understand the role of other executives on market perceptions of firms and their actions

Source: Harrison, J., Thurgood, G. R., & Pfarrer, M. D. (In Press). Perception is reality: How CEOs' observed personality influences market perceptions of firm risk and shareholder returns. *Academy of Management Journal*. doi: 10.5465/amj.2018.0626.