

Available online at www.sciencedirect.com



RESEARCH IN ACTION

Star CEOs

Benefit or burden?

JAMES B. WADE
TIMOTHY G. POLLOCK

JOSEPH F. PORAC
SCOTT D. GRAFFIN

Imagine that one day you get a call from a national news magazine saying they want to write an article profiling the great job you are doing as CEO. They might even make the article the cover story! In encouraging you to participate, they tell you the article will increase the visibility and reputation of both you and your firm and is likely to lead to more recognition in the future.

How should you feel about this impending wave of media attention? Should you nonchalantly recognize this as part of what it means to be a successful CEO? Should you be excited and embrace your new fame, perhaps writing a book to elaborate on your recipe for success and mounting a speaking tour? Or, should you be leery that fame may bring with it the burden of increased scrutiny and higher performance expectations that your firm may or may not be able to meet?

At one time or another, these questions are likely to confront any CEO of a large, high-performing corporation. Given the pressure put on media outlets by 24-hour news cycles, coupled with our celebrity-obsessed culture, it is little wonder that the

business press has turned the powerful but heretofore largely anonymous CEOs of America's most successful corporations into celebrities in their own right. Thus, top managers would do well to consider these questions, because more and more research suggests that media attention and adoration brings with it both benefits and burdens. On the one hand, certain CEOs are recognized and glorified by the media and are given a disproportionate share of the credit for favorable firm outcomes during their tenure. But beneath the surface of the media's glare is a tangle of burdens that can make it difficult for star CEOs to stay on top. And when a celebrity CEO falls from grace, the fall can be rapid and complete.

Before the collapse of Enron Corp., for example, Kenneth Lay was hailed as a visionary who was revolutionizing how the public utility industry did business. In less than a few months time, however, these accolades turned to jeers and Lay was crucified in the business press for his company's shoddy and misleading accounting practices. Similarly, Dennis Kozlowski was widely praised for

turning Tyco International into a powerhouse consumer products and services behemoth. In short order, however, Kozlowski became embroiled in media stories of financial excess, greed, and resource misappropriations that ultimately landed him in jail and Tyco in bankruptcy. While not all falls from grace land the executive in jail, they can still be costly, if not to the CEO's personal finances, than to his or her reputation. For example, after years of accolades for reinvigorating Merrill Lynch & Co.'s profitability, Stan O'Neil was forced to retire in disgrace after the firm announced massive losses due to write-downs in the value of its risky subprime mortgage bond portfolio. However, as a parting gift he received approximately \$160 million in deferred compensation and retirement benefits.

In still other cases, CEOs slide from grace gradually and over time. Even the poster boy for celebrity CEOs – Jack Welch – suffered from the media glare in this way. Welch was perhaps the epitome of the modern-day celebrity CEO. He was cheered for revitalizing General Electric Co. (GE) during his 20-year tenure at the helm, received every accolade and award that can be heaped upon a business executive, and saw his management practices written about extensively in the business press. Five years after Welch was lauded by *Business Week* as America's top CEO, however, a cover story in *Fortune* magazine disavowed many of his management maxims and questioned whether his management acumen at GE was really just smoke and mirrors.

These and other such incidents indicate that fame has both positive and negative consequences for celebrity CEOs and the firms they lead. Given the pressures and processes that gave rise to the celebrity CEO phenomenon show no signs of abating, it is important to understand what these consequences are and how can they be integrated into a more general framework of leadership and governance. In a study published in the *Academy of Management Journal*, we addressed this complex web of interdependencies by investigating the benefits and

burdens of stardom for both CEOs and their firms.

STAR CEOS AND FIRM PERFORMANCE

Common wisdom suggests that employing a highly celebrated CEO yields a number of tangible performance benefits for a firm. The presence of a star CEO can signal to investors and other key stakeholders that the CEO is of high quality and likely to add economic value to the company. As a consequence, the firm may be able to attract higher quality employees, acquire capital at lower rates and transact with suppliers under more favorable terms. Such CEOs may also translate the credibility associated with being anointed a star into increased power when dealing with important internal and external constituencies. Boards of directors, who play an important role in monitoring management, may be less likely to question the actions and decisions of a star CEO, enabling him or her to assert greater control over firm actions and outcomes. Although a star CEO will be able to solicit valuable advice from board members, s/he will not be constrained by it. To the extent that star CEOs are in fact more skilled or competent than other less-celebrated CEOs, this increased discretion could translate into relatively higher performance for their firms.

On the other hand, there are reasons to believe that hiring a star CEO may not always be to a firm's advantage. Being anointed a star might lead to hubris and overconfidence. Indeed, some research has found that CEOs who have been successful in the past become too confident in their abilities and overestimate the expected returns from their investment decisions. Evidence has been found that well-known CEOs overpay for acquisitions and tend to invest in dubious pet projects funded by internal cash flows. If star CEOs start to believe their own press, they may begin to think that they are infallible and pursue risky initiatives that ultimately harm their firms.

In his autobiography Jack Welch discusses falling prey to this sort of hubris in a chapter titled 'Too Full of Myself'. Despite initial objections from some directors, Welch talked the board into acquiring an investment banking firm, Kidder Peabody. In reflecting upon this acquisition, which ultimately failed, Welch wrote, "It was a classic case of hubris. Flush from the success of our acquisitions of RCA in 1985 and Employers Reinsurance in 1984, I was on a roll. Frankly, I was just full of myself." Post mortem examinations of the Enron and Tyco incidents suggest CEO hubris might have played a role in these cases, as well.

Star CEOs also seem prone to participate in self-enhancing activities unrelated to their company's business that divert their focus from running their firms. For example, many observers attribute American Express Co.'s financial difficulties in the early nineties to a loss of focus by its well-known CEO, James Robinson III. During Robinson's tenure, American Express (AMEX) made numerous acquisitions in an effort to become a "financial supermarket" that could serve all of an investor's financial needs. While American Express was attempting to integrate their increasingly diverse financial service business units, Robinson spent much of his time speaking at conferences addressing ways to deal with the debt of third-world countries and on other activities that were not central to the welfare of his firm. Critics argued that these activities diverted Robinson's attention from ensuring that American Express was creating value and exploiting synergies across its newly acquired businesses. Robinson eventually wore out his welcome with AMEX's board and resigned under pressure. Similarly, following the merger of Hewlett-Packard Co. and Compaq Computer Corp., HP's Carly Fiorina was criticized – and ultimately removed from her position as CEO – for her frequent absences from the company because of her outside speaking commitments. Her resistance to the HP board's efforts to hire a chief operating officer to oversee the complex details of integrating the two firms hastened her demise.

The presence of a star CEO can also have negative effects on the morale of other executives within the firm. Some researchers have suggested that a winner-take-all market exists among corporate executives, in that those at the very top of an organization receive disproportionate rewards for very small differences in ability. The presence of a star CEO can exacerbate these effects and lead to even greater salary inequality among the top management team and other key employees. Basic notions of fairness suggest that the disproportionate attention given to star CEOs and their salaries may be perceived as unfair by other executive and non-executive employees. In firms where teamwork is the key to achieving and maintaining a competitive advantage, the anointing of a star CEO might undermine executive teamwork, lead to turnover in the executive suite and in general have a harmful effect on the quality of organizational decisions.

For instance, when Robert Nardelli, a Jack Welch protégée, failed to become Welch's successor, he was highly sought after and ultimately hired with great fanfare as The Home Depot Inc.'s new CEO in 2001. However, many former Home Depot executives suggested that his pay package (\$245 million over five years) was exorbitant and engendered much resentment, particularly given the lackluster performance of Home Depot's stock during his tenure. It also probably did not help that, upon joining Home Depot, Nardelli received numerous perks—the use of a plane for his personal trips, a new Mercedes every three years and a \$10 million loan that would be forgiven after five years. During his tenure, Nardelli's style alienated many executives in the upper ranks who ultimately left the company. As Edward Lawler, the director of the Center for Effective Organizations at the University of Southern California's Marshall School of Business, put it, "He's not a very humble guy. He seems to have enormous energy, but needs to be front and center, and that can wear on the board and the employees after a while." Ultimately Nardelli was ousted, following his poor handling of the annual shareholder's

meeting in early 2007. As news of his resignation reached employees, an Atlanta store manager reported that, "It's amazing the reaction of people on my floor. People are openly ecstatic. High-fiving. There's a group talking about going to happy hour at noon." At the end of the day, Nardelli's inability to inspire loyalty among his employees likely played a large role in his ouster.

STAR CEOS AND EXECUTIVE COMPENSATION

Cases like these raise questions about whether the price firms pay to attract star CEOs is really money well spent. Many believe that high pay for good CEOs is a wise investment in managerial talent. Boards appear particularly prone toward this belief. According to current Securities and Exchange Commission rules, the board's compensation committee must submit a short statement describing the firm's executive pay policies. In examining these statements, researchers have found that they frequently justify high pay as being essential in attracting and retaining top executive talent. Of course, if a CEO is of truly high quality and s/he makes a substantial impact on a firm's bottom line, it makes sense that s/he should be highly rewarded. In echoing this idea, the renowned investor Warren Buffett once commented that, "You'll never pay a really top-notch executive . . . as much as they are worth. A million, \$3 million, or \$10 million, it's still peanuts."

While such sentiments might allow a highly celebrated CEO to garner a compensation premium compared with lesser-known executives, they may also lead investors to increase their performance expectations for firms that employ star CEOs and hold well-paid stars more accountable for future firm performance. If subsequent firm performance is high, the star CEO should receive an additional compensation premium because the board attributes the firm's success to his or her wisdom and expertise. On the other hand, if the firm performs poorly, it will be more difficult for the star

CEO to deflect blame, particularly if the CEO has taken actions to cultivate his or her own celebrity. In this instance, a CEO who has previously achieved high levels of recognition may be held more responsible for the firm's poor performance and receive a greater compensation penalty compared with a less-celebrated CEO. Indeed, Nardelli's high profile and fame at Home Depot is probably one reason that board members demanded his future pay be more closely tied to shareholder gains—a demand he ultimately rejected. In other words, while celebrity can bring opportunities, it also invites greater scrutiny. This increased attention and visibility can be beneficial when the high expectations of stakeholders are met; but it can also lead to heavy penalties when they are not. In short, CEO star status seems to be a double-edged sword because it carries with it both the benefits and the burdens of celebrity.

RESEARCH

In our research, we used the results of the CEO of the Year contest run by *Financial World* magazine to investigate whether star CEOs actually add value to the firms that employ them. In addition, we explored the relationship between star status and executive compensation. We gathered data on 282 companies in the S&P 500 from 1992 to 1996 and identified star CEOs using *Financial World's* CEO of the Year contest. Each year *Financial World* singled out star CEOs by surveying over 1000 peer CEOs and a large number of stock analysts. These raters ranked CEOs on a variety of financial and non-financial measures, including whether the company was a performance leader in the industry, whether the CEO had assembled an exceptional and effective team and whether the CEO had made positive contributions to his or her industry. Exemplary CEOs were then awarded gold, silver and bronze medals and the results of the contest were publicized in *Financial World*. Winning CEOs in our sample included such luminaries of the period as Jack Welch of GE,

Kenneth Lay of Enron, Larry Bossidy of AlliedSignal, Wayne Huizenga of Blockbuster Inc., and George Fischer of Eastman Kodak Co.

In assessing the value of having a star CEO at the helm, we first investigated how winning a medal affects firm performance. We found that firms with medal-winning CEOs were more positively evaluated by the stock market in the 3 days following the announcement of the medal. However, in the longer term the market's sentiment toward the companies became more negative. By 240 days after the medal was awarded, the average return of medal-winning firms decreased by 8.23%. These results suggest that while shareholders initially valued the presence of a star CEO, the positive effects faded rapidly and actually turned negative over time. Interestingly, the presence of a star CEO had no effect on accounting performance. We interpret these results as meaning investor expectations became more stringent after a CEO won a medal, and that, on average, medal-winning CEOs ultimately failed to meet these expectations.

In analyzing how star status affects a CEO's compensation, we found that star CEOs received a compensation premium of nearly 11% immediately after winning a medal. This translates into a pay raise of roughly \$265,000 for a medal-winning CEO. The longer-term impact of winning a medal, however, depended to a large extent on the firm's subsequent performance. If the firm performed well, medal-winning CEOs continued to enjoy higher pay when compared with equivalent performance achieved by their less renowned counterparts. However, when performance was poor, star CEOs received *lower* compensation than CEOs who had never won a medal and achieved the same level of performance.

IMPLICATIONS FOR MANAGERS AND BOARDS

At the beginning of this article we posed the question: should CEOs who are glorified by

the financial press be excited and embrace this new fame, simply recognize it as part of being a successful CEO, or be leery that the fame may bring the burden of increased expectations that cannot be met? Our results suggest that CEOs have reasons to experience all three reactions. Celebrity CEOs should be excited that they have been singled out, because both they and their company will likely be rewarded in the short term. However, they should also be somewhat leery that their star status could penalize both them and their firms if they do not continue to perform well. Despite all of the positive benefits that stellar reputations may bring for firms and executives, star CEOs would do well to keep in mind the cautionary words of Charles Fombrun that, "The reputations they earn from doing some things particularly well sit on the slippery ground of their constituents' fickle interpretations." This fickleness seems part of the celebrity CEO's lot in life.

One explanation for our pattern of firm performance and CEO compensation is that media attention brings with it what Fombrun called the "burden of celebrity". Following an award, firm stock performance and CEO pay each increase in the short-term as stakeholders initially respond positively to this third-party endorsement of CEO quality. At the same time, however, these awards heighten investors' expectations about future performance and these expectations are difficult to meet. As a result, firms with star CEOs generally experience lower stock market returns over the longer term. Similarly, while boards of directors may grant star CEOs more discretion, they also seem to impose an evaluative gauntlet that celebrity CEOs must pass in order to continue receiving positive returns from their star status. Thus, in the eyes of both shareholders and board members, star CEOs and their firms incur a burden of celebrity.

Overall, our results provide cautionary information for boards of directors and compensation committees charged with deciding how to reward and/or retain top executives. Because we found that star CEOs do not

seem to positively influence profitability in the years following an award announcement, the idea that companies should offer substantial pay premiums to retain high-status CEOs seems misplaced. This may be especially true given that media attention seems to bring with it a burden of higher performance expectations that, on average, go unmet—thus leading to a decline in the firm's market performance over the longer term. At the same time, however, boards may be able to reduce the costs of retaining a star CEO by offering him or her more incentive-laden pay. While this increased performance pay sensitivity is certainly desirable from the firm's perspective, our results show that the hurdle star CEOs have to clear is relatively low. Medal-winning CEOs simply had to be at the 11th percentile of firm performance or better to receive benefits from their star status. On balance, it appears that having a star CEO may not be in a firm's best interests, particularly if high premiums are paid because of the CEO's celebrity status.

While our particular study examined the effects of an award granted by external constituents, it is undoubtedly true that, through public relations efforts, CEOs and their firms have an important impact on whether a CEO becomes well known or stays relatively anonymous. Indeed, the pursuit of celebrity for a company's CEO is often a conscious choice made at the highest levels. For example, Carly Fiorina's efforts to court media attention prompted Jim Collins, the author of *Good to Great*, to once remark, "Whose brand was she building anyway? It sure looked like the brand of Carly would soon eclipse the brand of HP." In the end, however, as an article by Ben Elgin of *Business Week* noted, "it had become increasingly clear that HP's need for a nuts-and-bolts operations whiz far outweighed the benefits of a high-profile CEO." And this is exactly the type of CEO that HP hired to replace Fiorina.

In contrast, consider the record of Colgate-Palmolive Co., which during the 23-year tenure of its CEO, Reuben Mark, exceeded the total return of the S&P 500 by over 2.7 times and outperformed its peers between

2002 and 2007 by 15%. Much of the credit for the firm's success probably goes to Mr. Mark, who, because of his proclivity to shun the spotlight and focus on nuts and bolts issues, was often referred to in the press as the "anonymous CEO". In describing his management philosophy, which emphasized valuing the contributions of others, building a cohesive culture, and gradually implementing improvements, Mark noted in a recent leadership lecture at a well-known business school that, "it's not romantic and not revolutionary or headline getting, but over time, that's what generates success." In our view, this is a philosophy that other CEOs might be wise to emulate.

So, what lessons does our study provide for executives and directors? First, do not become dazzled by the shining star. With celebrity comes heightened investor expectations that can be difficult to meet, and their disappointment can lead to diminished stock performance. At the same time, if the company's CEO is already a star, or the board has decided to pursue a star CEO, an opportunity exists to align CEO pay and company performance more closely. This is because a star CEO's confidence and belief in his or her own ability leads the CEO to happily accept a more performance-based compensation contract as an indicator of competence. Thus, boards negotiating with star CEOs have the opportunity to do what many shareholders and the media continually chastise them for not doing—tie CEO pay more closely to corporate performance. If their company subsequently performs well and the CEO is highly rewarded, the board can more plausibly claim the rewards are commensurate with performance. And if subsequent performance is below expectations and CEO pay is reduced below the levels other CEOs receive for the same outcome, the board has an opportunity to trumpet its toughness and responsible behavior as stewards of shareholders' interests.



To order reprints of this article, please call +1(212)633-3813 or e-mail reprints@elsevier.com



SELECTED BIBLIOGRAPHY

For a review of academic work on executive pay, see Harry G. Barkema and Luis R. Gomez-Mejia, "Managerial Compensation and Firm Performance: A General Research Framework," *Academy of Management Journal*, 1994, 41, 135–145; Lucian A. Bebchuk and Jesse M. Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press, 2004); Graef S. Crystal, *In Search of Excess* (Norton and Company, 1991); Cynthia E. Devers, Albert A. Cannella Jr., Gregory P. Reilly and Michele M. Yoder, M. "Executive Compensation: A Multidisciplinary Review and Synthesis of Recent Developments," *Journal of Management*, 2007, 33 (6), 1016–1072; Barry Gerhart and Sara L. Rynes, *Compensation: Theory, Evidence, and Strategic Implications*. (Sage, 2003); Robert Gibbons and Kevin Murphy, "Relative Performance Evaluation for Chief Executive Officers," *Industrial and Labor Relations Review*, 1990, 43, 30s–51s; Michael C. Jensen and Kevin J. Murphy, "Performance Pay and Top Management Incentives," *Journal of Political Economy*, 1990, 98, 225–263; Henry L. Tosi and Luis R. Gomez-Mejia, L., "The Decoupling of CEO Pay and Performance: An Agency Theory Perspective," *Administrative Science Quarterly*, 1989, 34, 169–189; James B. Wade, Joseph F. Porac, Timothy G. Pollock, "Worth, Words and the Justification of Executive Pay," *Journal of Organizational Behavior*, 1997, 18, 641–664.

For sources on the role of the financial press in influencing organizational outcomes, see: Chao C. Chen and James R. Meindl, "The Construction of Leadership Images in the Popular Press: The Case of Donald Burr and People Express," *Administrative Science Quarterly*, 1991, 36, 525–551; David L. Deephouse, "Media Reputation as

a Strategic Resource: An Integration of Mass Communication and Resource-Based Theories," *Journal of Management*, 2000, 6, 1091–1112; Ben Elgin, "The Inside Story of Carly's Outster," *Business Week*, 10 February 2005; Kimberly D. Elsbach and Roderick M. Kramer, "Members' Responses to Organizational Threats: Encountering and Countering the Business Week Rankings," *Administrative Science Quarterly*, 1996, 41, 442–476; Charles J. Fombrun and Mark Shanley, "What's in a Name: Reputation Building and Corporate Strategy," *Academy of Management Journal*, 1990, 33, 233–258; Matthew L. Hayward and Don C. Hambrick, "Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris," *Administrative Science Quarterly*, 1997, 42, 103–127; Timothy G. Pollock and Violina P. Rindova, "Media Legitimation Effects in the Market for Initial Public Offerings," *Academy of Management Journal*, 2003, 46 (5), 631–642; Hayagreeva Rao, "The Social Construction of Reputation: Certification Contests, Legitimation, and the Survival of Organizations in the American Auto Industry, 1895–1912," *Strategic Management Journal*, 1994, 15, 29–44; W. Gerry Sanders and Steven Boivie, "Sorting Things Out: Valuation of New Firms in Uncertain Markets," *Strategic Management Journal*, 2004, 25, 167–186.

For sources that specifically examine the role of media attention on CEOs and other executives, see: Scott D. Graffin, James B. Wade, Joseph F. Porac and Robert C. McNamee, "The Impact of CEO Status Diffusion on the Economic Outcomes of Other Senior Managers," *Organization Science*, forthcoming; Matthew L.A. Hayward and Don C. Hambrick, "Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO

Hubris," *Administrative Science Quarterly*, 1997, 42, 103–127; Matthew L.A. Hayward, Violina P. Rindova and Timothy G. Pollock, "Believing One's Own Press: The Causes and Consequences of CEO Celebrity," *Strategic Management Journal*, 1997, 25, 637–653; Jonathon L. Johnson, Alan E. Ellstrand, Catherine M. Daily and Dan R. Dalton, "Board Reputation and Stockholder Wealth: The Influence of the Financial Press," *Strategic Management Journal*, 2005, 26, 461–471; Rakesh Khurana,

Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs (Princeton University Press, 2003); Ulrik Malmendier and Geoffrey A. Tate, "Does Overconfidence Affect Corporate Investment? CEO Overconfidence Measures Revisited," *European Financial Management*, 2005, 11, 649–659; James R. Meindl, Sanford B. Ehrlich and Janet M. Dukerich, "The Romance of Leadership," *Administrative Science Quarterly*, 1985, 30, 78–102.

James B. Wade is a professor at Georgetown University's McDonough School of Business. He received his Ph.D. in organizational behavior and industrial relations from the University of California, Berkeley. His research interests include organizational ecology, social movements, and top management team issues. His research in these areas has appeared in scholarly journals such as *Administrative Science Quarterly*, *Academy of Management Journal*, *Organization Science*, *Strategic Management Journal* and other outlets. (Tel.: +1 202 687 3737; e-mail: jbw42@georgetown.edu.)

Joseph F. Porac is the George Daly Professor in Business Leadership at New York University's Stern School of Business. He received his Ph.D. from the University of Rochester. His research explores the cognitive foundations of organizing at multiple levels of analysis, including organizational governance. (Tel.: +1 212 998 0215; e-mail: jporac@stern.nyu.edu.)

Timothy G. Pollock (Ph.D., University of Illinois at Urbana-Champaign) is an associate professor in the Smeal College of Business at Penn State University. His research explores the role social resources such as reputation, celebrity, social capital, legitimacy and power play in shaping corporate governance activities, strategic choice, and the IPO market. (Tel.: +1 814 863 0740; email: tpollock@psu.edu.)

Scott D. Graffin is an assistant professor at the University of Georgia's Terry College of Business. He received his Ph.D. in strategic management and organization theory from the University of Wisconsin, Madison. His research interests include corporate governance, and the impact of reputation, status, and the financial press on organization outcomes. His research in these areas has appeared in scholarly journals such as *Academy of Management Journal*, *Organization Science*, and other outlets. (Tel.: +1 706 542 4046; e-mail: sgraffin@terry.uga.edu.)