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The CEO Experience Trap

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[EXECUTIVE HIRING]

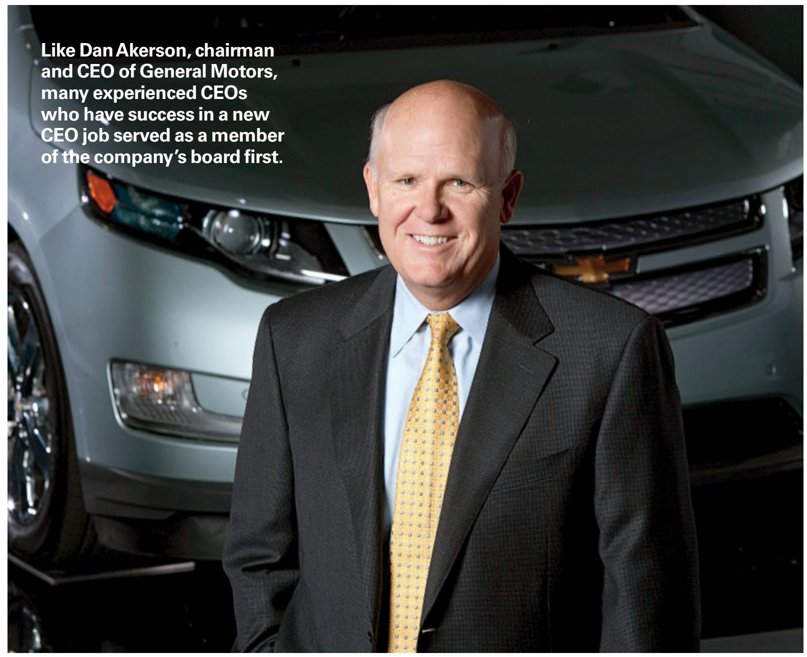
The CEO Experience Trap

Companies increasingly seek to hire CEOs with previous experience in the role. However, new research suggests that is not always a wise choice.

BY MONIKA HAMORI AND BURAK KOYUNCU

"A lot of chief executives look very successful and are very successful in a company at a point in time. They look like geniuses. But the real test is if you take that genius and put him in a totally different situation to succeed again. And to do that, they have to be able to listen, able to understand, able to hear why the culture is totally different . . . the behavior that worked where you worked before ain't gonna work here."

— **Archie Norman**, former CEO of the U.K. supermarket chain Asda Stores Ltd., when asked for advice that he would give to other CEOs.



Like Dan Akerson, chairman and CEO of General Motors, many experienced CEOs who have success in a new CEO job served as a member of the company's board first.

A growing number of companies recruit CEOs with a proven track record. According to a Booz & Co. study of CEO succession at the world's biggest public companies, almost 20% of both incoming and departing CEOs at such companies in 2008 had had CEO experience at another corporation, almost twice the average percentage for the 11 years studied. Companies resort to hiring prior CEOs because they are increasingly unwilling to take the risk of hiring executives with no previous job-specific experience. They also assume that CEO job experience provides both a good track record and an understanding of the role.

But is this assumption correct? To answer that question, we collected data on the career histories of the CEOs of S&P 500 corporations who occupied the CEO post as of 2005 and tracked their performances up to three years after their appointments to the CEO position. Industries included agriculture, mining, construction, manufacturing, transportation and utilities, financial services, retail and wholesale, and other services.

Out of the 501 CEOs we looked at, 19.6% had at least one prior CEO job. Our research found that these prior CEOs performed worse than their peers without such experience. Being a prior CEO was negatively and significantly associated with three-year average post-succession return on assets.

Why Does This Happen?

One possibility is that experienced CEOs underperform their peers without job-specific experience because they face more hurdles in their new job: They have to lead organizations that have greater financial problems than those of their peers. However, when we compared the pre-succession financial performance (return on assets and return on sales) and the debt-to-equity ratios of companies that experienced and non-experienced CEOs took over, we found that the two groups of companies showed no statistically significant differences in financial performance. Company performance before the succession event therefore cannot explain why CEOs with previous CEO experience saw lower post-succession performance than their peers who did not possess prior CEO experience.

Another possibility is that chief executives with prior experience as a CEO face performance problems because they are outsiders who do not possess company-specific human capital and cannot tap into the social networks of the new organization. Our results indicate, however, that outsiders without prior CEO experience showed no significant differences from those CEOs who ascended to the CEO post from within the organization. In sum, outsider status alone does not explain why prior CEOs underperform their peers.

We suspect that the job-specific experience these CEOs gained in their prior CEO job or jobs interferes with their performance in the new position. Their job-specific experience may slow down learning because some knowledge and techniques need to be "unlearned"

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before learning in the new context can take place. In addition, as prior CEOs rely on experience from past events, they are more likely to follow decision-making shortcuts, and this may cause them to give the same answer to a different problem. Prior CEOs may be too embedded in the norms, culture and routines of one organization and thus may underperform in another because they have developed fixed assumptions about how tasks should be done.

Our results support this idea of a CEO experience trap. We find that those CEOs who directly transition from a prior CEO job to the new CEO job do worse (that is, they have a 48% lower three-year average post-succession return on assets) than CEOs without prior experience. By contrast, CEOs who spent some time working in a different position between two CEO jobs had no significant difference in performance than CEOs without prior experience, presumably because they were able to unlearn some of their previous experience during that time.

Further, prior CEO experience in a similar-sized company was negatively associated with post-succession performance. Similarly, CEOs with prior CEO experience in the same industry also have worse post-succession company performance than CEOs without prior CEO experience. However, prior CEOs whose experience was in a different-sized company or a different industry did not face worse post-succession company performance than their peers without previous CEO experience.

These results may be surprising, but they are consistent with findings by other researchers that large U.S. publicly traded companies that hire prior CEOs have lower return on assets, higher debt ratios and higher chances of bankruptcy up to three years after the succession event than companies with other types of succession events, even though the stock returns of these companies increase.

There are signs of an "experience trap" for other occupations, as well. For instance, several studies found that entrepreneurs who were successful at a certain stage of the product life cycle, with skills well-adapted to that stage, experienced failure as they led ventures in other parts of the product life cycle or industry evolution. Other research shows drops in job performance by stock analysts and call center operators in the insurance industry after moving to a different employer.

Avoiding the Experience Trap

Our results suggest that hiring organizations should give more careful consideration to whether they want to hire CEOs with prior experience in the role. One recommendation when hiring CEOs with prior experience is to have them in an interim position at the organization for at least a year before they take the CEO post. That would allow them to acquire company-specific human and social capital and, more importantly, to unlearn some of the knowledge and assumptions specific to their old job.

If an interim position is not possible, another solution may be to immerse a future CEO in the company's operations before he or she takes the CEO job. Although this approach would not help experienced CEOs unlearn the knowledge and assumptions from their old job, it may help their acculturation to the new CEO role. In fact, many ex-CEOs who have success in their new CEO jobs served as a member of the board of the company before being appointed to the new CEO position.

A good example of this approach is Dan Akerson, who was the chairman and CEO of two telecom companies, Nextel and XO Communications, before he was appointed to become the CEO of General Motors in September 2010. Akerson was already very familiar with GM's operations at that point because he had been serving as a board member for GM since July 2009. Four months after his appointment as CEO, the business press enthusiastically praised his reorganization efforts. Indeed, although in 2005 — a boom year for the auto industry — GM posted a net loss, in 2010 the company reported $4.7 billion in net income.

RELATED RESEARCH

- **M. Hamori and B. Koyuncu, "Experience Matters? The Impact of Prior CEO Experience on Firm Performance," Human Resource Management, forthcoming.**

Another example of an experienced CEO first serving on the board of a company he later joined as CEO is John Rishton, who served a stint of three years as the CEO of the Dutch retailer Royal Ahold NV before becoming the chief executive of Rolls-Royce Holdings plc in April 2011. Rishton had been a non-executive board member of Rolls-Royce since 2007 and the chairman of its audit committee. During his board tenure at Rolls Royce, he won the trust of his fellow board members, who voted unanimously to give him the job of chief executive. The succession process at Rolls-Royce took a year and was very carefully planned and executed. The company's profits increased by more than a fifth in 2011, thanks to a strong performance in its maintenance and repair division as well as a joint venture with Daimler AG.

In general, companies that hire CEOs with prior CEO experience need to provide ample support to their transition and integration, with, for example, collaboration with the outgoing CEO, if he or she is retained as a chairman. The greater the opportunity for acculturation, the greater the chance the company can avoid falling into the CEO experience trap.

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