EGOS 2022: Organizing: the beauty of imperfection
Sub-theme 27: Exploring imperfections of boards' work: conflict, failures, and faultlines

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Why outsider CEOs do (not) bring strategic change: a relational perspective

Extant research on Chief Executive Officer (CEO) succession has long studied whether hiring an new CEO from outside the firm is the right path for firms to swiftly realize strategic change (Berns & Klarner, 2017; O'Riordan, Kelliher & Flood, 2019; Finkelstein, Hambrick & Cannella, 2009). Building on upper echelon theory, CEO succession scholars posit that new CEOs play a crucial role in generating strategic changes through their strategic choices for the company (Hambrick & Mason, 1984).

The CEO origin, i.e.: whether the new CEO is hired from inside or outside the firm, is an important determinant of strategic renewal (Berns & Klarner, 2017). Extant literature on CEO succession widely believes that outsider CEOs are more likely to initiate changes than insiders (Berns & Klarner, 2017; O'Riordan, Kelliher & Flood, 2019) due to certain characteristics of outsiders which are in favour of changes. For example, outsiders tend to be "cognitively open-minded, with low commitment to the status quo, able to envision and consider new courses of action, and socially and interpersonally unencumbered, with few attachments to internal executive…" (Finkelstein et al., 2009: 190). There is an assumption that appointing an outsider CEO results in a bolder approach to changing the corporate strategic status quo by promoting the transfer of new knowledge from outside the firm's boundaries and questioning the pre-established corporate process (Shen & Cannella, 2002). Yet, several scholars point to the problems experienced by outsider CEOs related to their lack of knowledge and understanding about how the organization operates (Karaevli & Zajac, 2013). Studies have shown that outsider CEOs require more time to develop their leadership capabilities before responding to the internal and external imperatives surrounding the organization (Georgakakis & Ruigrok, 2017; Shen, 2003). In addition to the relative lack of familiarity with the organization's internal idiosyncrasies, outsider CEOs are required also to develop social capital within their new company. The initial lack of relational capital may constrain outsiders compared to insider CEOs from making sweeping changes to the organization. Empirical evidence shows that outsider CEOs are less likely to make strategic change than insiders under a poor pre-succession performance (Karaevli & Zajac, 2013).

This raises the question about the underlying dynamics of these very different outcomes: **Why do outsider CEOs manage to generate more strategic changes and when and why does this positive relationship not hold?** In other words, the direct effect of outside succession on strategic change is challenged (O'Riordan et al., 2019) and a deeper exploration of the mediators is needed. Particularly, it may not be the "insider vs. outsider status" of the new CEO leading to changes (Finkelstein et al., 2009), but the features and characteristics associated with outside successors affecting their strategic behaviours (Bromiley & Rau, 2016; Finkelstein et al., 2009; Shen & Cannella, 2002; Finkelstein & Hambrick, 1996).

In this paper we draw on a relational perspective to address this question and explore the impact of outsider CEOs' networks on the outsider succession – strategic change relationship in crisis versus non-crisis situation. We argue that the degree to which an outsider CEO is associated with strategic change in different conditions depends on the new CEO's relational network with 1) the board of directors, and 2) external business elites, *prior* to appointment. A relational perspective posits that individuals are connected; the relation with others and the network patterns formed by these relations affect an individual's cognition and behaviours (Martin & Wellman, 2011). Relations between individuals enable communication and foster trust which facilitate information exchange, encourage the seeking and sharing of advice, and promote cooperative problem-solving (Carpenter Li & Jiang, 2012; Westphal, 1999). This aspect is notable because a new CEO (whether an insider or an outsider) has to learn and adapt, and his or her networks inside and outside the firm provide relevant information, knowledge, and advice for making a firm's strategic decisions.

The firm's board of directors is one of the best sources of advice on the firm's strategic issues for new CEOs (Ma, Kor & Seidl 2020; Westphal, 1999). CEOs are more likely to seek advice from board members with whom they have stronger ties (Ma et al., 2020; Westphal, 1999). However, individuals embedded in same network for a long time tend to face limited access to novel information, alternative or conflicting views, and knowledge about outside business opportunities (Opper & Burt, 2020). Extensive networks with external business elites and organisations bring fresh information and resources to the company, which gives more choices to the new CEO to reorient the strategy (Chen, Treviño & Hambrick, 2009). A corporate crisis signalling a high urgency for change (Trahms, Ndofor & Sirmon, 2013), however, put stress on the relations between the new CEO and internal stakeholders, especially when the new CEO is hired from outside the firm; trust-based relationships between the new CEO and board members, in this condition, are important for sharing company's internal information on the problems and insightful advices on turnaround strategy (Berns & Klarner, 2017; Ma et.al., 2020; Boyd, Haynes & Zona, 2011). Based on the above arguments, we propose a theoretical framework (Figure 1) suggesting that an outsider CEO's weaker network with board members and larger network with external business elites acts as an accelerator for strategic change in the business-as-usual situation, but hinders the implementation of strategic change in firms under a crisis situation.

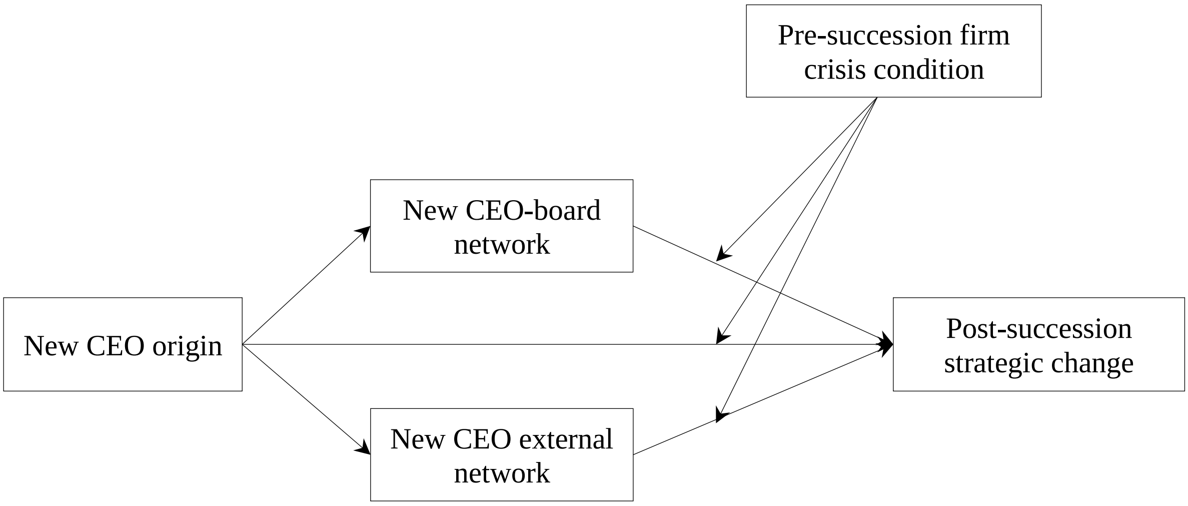

Figure 1: theoretical framework

Hypothesis 1: The relationship between new CEO origin and post-succession strategic change is moderated by pre-succession firm crisis situation. In other words, outsider CEOs will implement a higher level of strategic change when joining a firm in a business-as-usual situation, but a lower level of strategic change in a crisis situation.

Hypothesis 2: A new CEO with a) a larger firm internal network or b) stronger network ties with board members will implement a higher (lower) level of strategic change after joining in the firm under crisis (business-as-usual) condition.

Hypothesis 3: The effect of new CEO origin on post-succession strategic change is mediated *by the new CEO-board network; an outsider CEO tends to have a) a smaller firm internal networks or b) weaker network ties with board members, and thus, is able to implement a lower (higher) level of strategic change after joining in the firm under crisis (business-as-usual) condition.*

Hypothesis 4: A new CEO with larger external network with the business elites will implement a lower (higher) level of strategic change after joining in the firm under crisis (business-as-usual) condition.

Hypothesis 5: The effect of new CEO origin on post-succession strategic change is mediated by the new CEO-board network; an outsider CEO tends to have a larger external network with the business elites, and thus, is able to implement a lower (higher) level of strategic change after joining in the firm under crisis (business-as-usual) condition.

We conduct a quantitative empirical analysis of new CEOs appointed by S&P 1500 companies between 2000 and 2017. We identify 4063 CEO replacement cases, excluding interim CEOs and co-CEOs. Consistent with the literature on strategic change (Datta, Rajagopalan & Zhang, 2003; Finkelstein & Hambrick, 1990; Karaevli & Zajac, 2013; Oehmichen, Schrapp & Wolff, 2017; Zhang & Rajagopalan, 2010), we adopt a composite measure that includes six key strategic indicators: 1) advertising intensity, 2) R&D intensity, 3) plant and equipment newness, 4) nonproduction overhead, 5) inventory level, and 6) financial leverage. These indicators were chosen because they are subject to the control of the CEO and top management, and influence firm performance (Finkelstein & Hambrick, 1990). Following the outsider succession literature, we measure new CEO origin dichotomously, coding an inside CEO 0 and an outside CEO 1. We categorize the pre-succession firm condition by observing whether the company was facing a crisis before the succession or not; a crisis is identified by an abrupt operating loss following at least two years of very satisfactory performance (Chen & Hambrick, 2012). We adopt a dummy measure of the pre-succession firm condition, where a crisis condition is coded 1 and a business-as-usual condition 0. Regarding the network, we identify social ties between two individuals by observing simultaneous co-working, co-studying, and co-director relations in the same organization. We look at two aspects of the new CEO-board network: First, CEO network position is measured by the degree centrality of the CEO in the CEO-board network, adjusted by the board size (Freeman, 1978; Li, 2013); second, tie strength is measured as average duration of the relationship between the CEO and each board member (Carpenter et.al., 2012). New CEO external network is measured by the number of social ties with external business elites and organisations (Collins & Clarks, 2003). We include control variables at the CEO level (e.g., age, gender, duality, connection with the former CEO, and network size), the board level (e.g., board size, and change of board members), and firm level (firm size, and firm prior-year performance). The information on CEOs, board members, and their networks is from the *BoardEx* database and the information on companies is from the *Compustat* database. We test our hypotheses by ordinary least squares (OLS) regressions. The preliminary results are reported in Table 1 – 3 in the appendix, which provides support for our hypotheses.

We find that outsider CEOs bring more changes to the firm in a business-as-usual situation, but less changes in a crisis situation. More important, we find that an outsider CEO's weaker network with board members and larger network with external business elites explain his or her different contributions to firm's strategic change in the business-as-usual and crisis situations.

Our study contributes to the call for a better understanding of in the CEO-board relation in the succession process. (Berns and Klarner, 2017) by adopting a relational perspectives. In particular, we show that new CEO networks (i.e., relations with board members and with external business elites) explain the paradox between the outside succession's effect on strategic change in the business-as-usual situation and in crisis situations. Our work indicates that outsider CEOs' networks with board members *previous* to their CEO appointment play a key role in hindering strategic change in a business-as-usual situation but accelerate strategic change in a crisis situation. We thereby also highlight the critical role of networks for the successful implementation of strategic change.

We contribute to the sub-theme by questioning the assumption of outsider CEOs' advantages for making strategic changes. Our study shows that the positive outsider CEO – strategic change relationship does not hold if the firm is in a crisis situation (i.e., severe financial decline) and suggests that research on the effects of CEO succession must take the succession context more into account. Our work thereby also provides practical implications regarding the appointment and integration of a new CEO. Based on our findings, we suggest that when hiring an outsider CEO, firms should consider their financial situation to assess whether an outsider or an insider CEO tmay be best suited to bring about strategic change.

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APPENDIX

Figure 2: Effects of new CEO origin, new CEO-board networks, and new CEO external networks on strategic change (business-as-usual vs. crisis condition)

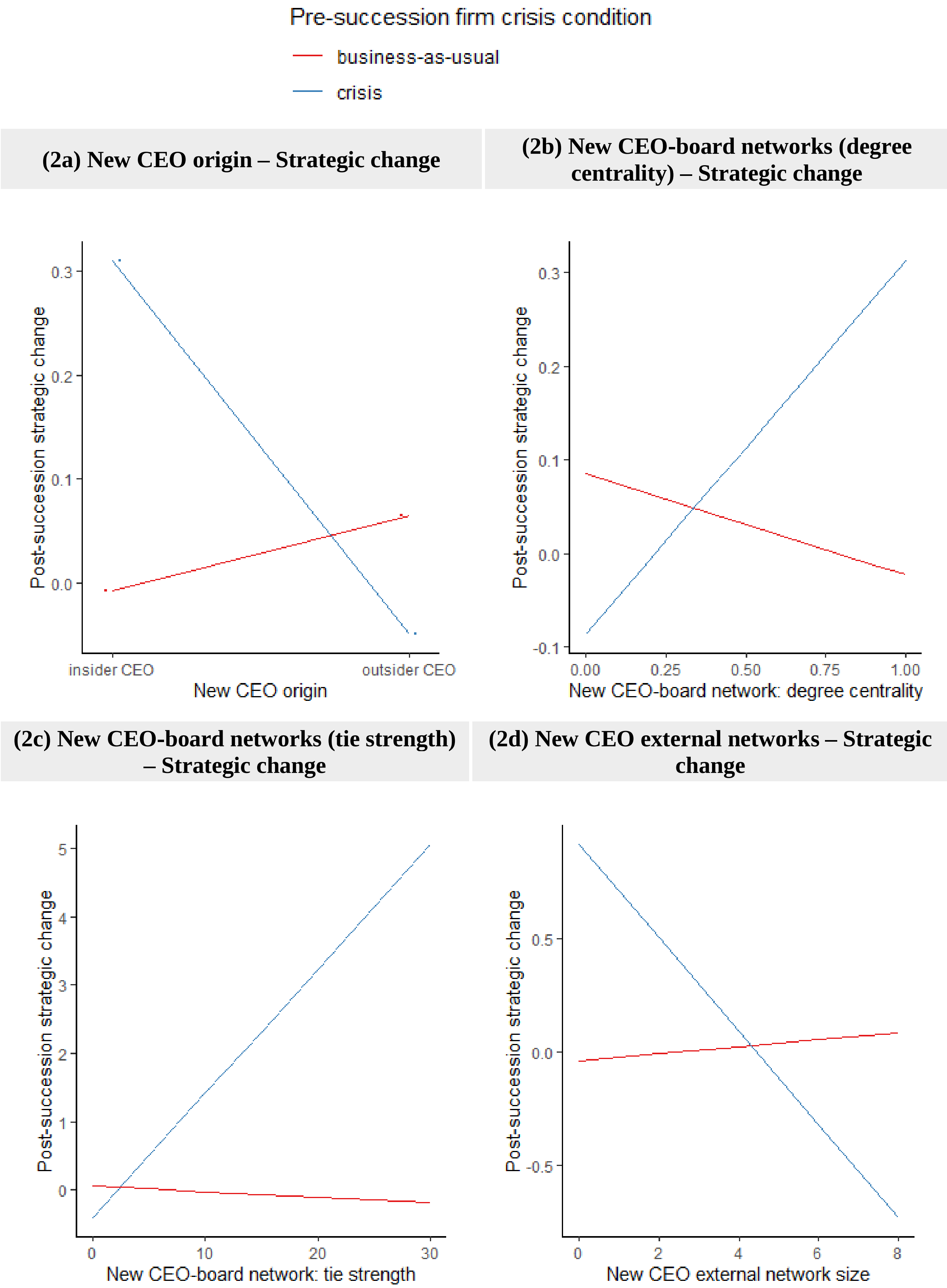

Table 1: Effects of new CEO origin on post-succession strategic change

	Strategic change		
	Model 1	*Model 2*	*Model 3*
Intercept	0.22	0.20	0.18
firm size	-0.02 *	-0.02 *	-0.02 *
firm prior-year performance	-0.84 ***	-0.83 ***	-0.81 ***
CEO age	-0.00	-0.00	-0.00
CEO gender	0.09	0.09	0.09
CEO duality	0.01	0.01	0.01
change of board member	0.28	0.24	0.24
board size	-0.01	-0.01	-0.01
former CEO relation	0.02	0.05	0.05
CEO network size	-0.00	-0.00	-0.00
new CEO origin (outsider)		**0.06 ***	**0.07 ***
Moderating effect			
pre-succession firm crisis condition (dummy)			0.32 **
new CEO origin * pre-succession firm crisis condition			**-0.43 ****
Observations	2248	2248	2248
R^2 / R^2 adjusted	0.072 / 0.068	0.074 / 0.070	0.079 / 0.074

* *p<0.05* ** *p<0.01* *** *p<0.001*

Table 2: Effects of new CEO-board networks on post-succession strategic change

	Strategic change					
	Model 4	*Model 5*	*Model 6*	*Model 7*	*Model 8*	*Model 9*
Intercept	0.25	0.24	0.21	0.23	0.21	0.19
firm size	-0.02 *	-0.02 *	-0.02 *	-0.02 *	-0.02 *	-0.02 *
firm prior-year performance	-0.84 ***	-0.83 ***	-0.82 ***	-0.84 ***	-0.81 ***	-0.80 ***
CEO age	-0.00	-0.00	-0.00	-0.00	-0.00	-0.00
CEO gender	0.09	0.09	0.09	0.09	0.10	0.10
CEO duality	0.01	0.01	0.01	0.01	0.01	0.01
change of board member	0.19	0.19	0.19	0.25	0.25	0.24
board size	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01
former CEO relation	0.07 *	0.07	0.08 *	0.03	0.03	0.05
CEO network size	-0.00	-0.00	-0.00	-0.00	-0.00	-0.01
new CEO origin (outsider)			0.05			0.06
CEO-board network: degree centrality	**-0.10**+	**-0.11** *	**-0.07**			
CEO-board network: tie strength				-0.00	-0.01 *	-0.01
<u>*Moderating effect*</u>						
pre-succession firm crisis condition (dummy)		-0.17	-0.17		-0.47 ***	-0.47 ***
CEO-board network: degree centrality * pre-succession firm crisis condition		**0.51** **	**0.51** **			
CEO-board network: tie strength * pre-succession firm crisis condition					**0.19** ***	**0.19** ***
Observations	2247	2247	2247	2247	2247	2247
R^2 / R^2 adjusted	0.074 / 0.069	0.077 / 0.072	0.078 / 0.073	0.073 / 0.068	0.106 / 0.101	0.107 / 0.102

$^+p<0.1$ $^*p<0.05$ $^{**}p<0.01$ $^{***}p<0.001$

Table 3: Effects of new CEO external networks on post-succession strategic change

	Strategic change		
	Model 10	*Model 11*	*Model 12*
Intercept	0.24	0.22	0.19
firm size	-0.02 *	-0.02 *	-0.02
firm prior performance	-0.84 ***	-0.82 ***	-0.81 ***
CEO age	-0.00	-0.00	-0.00
CEO gender	0.09	0.09	0.09
CEO duality	0.00	0.01	0.01
change of board member	0.27	0.28	0.24
board size	-0.01	-0.01	-0.01
predecessor-new CEO network	0.02	0.03	0.06 *
CEO network size	-0.00	-0.01	-0.01
new CEO origin (outsider)			**0.06**
CEO external network size	**0.01**+	**0.02**	**0.01**
<u>*Moderating effect*</u>			
pre-succession firm crisis condition (dummy)		0.95 ***	0.95 ***
CEO external network size * pre-succession firm crisis condition		**-0.22** ***	**-0.22** ***
Observations	2230	2230	2230
R^2 / R^2 adjusted	0.073 / 0.069	0.083 / 0.078	0.085 / 0.080

** p<0.05   ** p<0.01   *** p<0.001*