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

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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). 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). 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), where they 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, 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, especially when the organization is facing difficulties. 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 characteristics in various aspects associated with outside successors affecting their strategic behaviours (Bromiley & Rau, 2016; 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 situations. 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.

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. First, 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, e.g., of the boardroom, 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). A corporate crisis signalling a high urgency for change (Trahms, Ndofor & Sirmon, 2013), furthermore, 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). Second, 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). Based on the above arguments, we propose a theoretical framework 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.

We conduct a quantitative empirical analysis on the 4063 new CEOs appointed by S&P 1500 companies between 2000 and 2017. Consistent with the literature on strategic change (e.g., Zhang & Rajagopalan, 2010), we adopt a composite measure that includes four key strategic indicators: 1) plant and equipment newness, 2) nonproduction overhead, 3) inventory level, and 4) financial leverage, which are subject to the control of the CEO and top management, and influence firm performance (Finkelstein & Hambrick, 1990). 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 measure new CEO's network position by the degree centrality in the CEO-board network, adjusted by the board size (Freeman, 1978; Li, 2013) and tie strength by the 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 test our hypotheses by ordinary least squares (OLS) regressions and the preliminary results provide 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 & Klarner, 2017) by adopting a relational perspective. 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 prior to their CEO appointment play a key role in accelerating strategic change in a crisis situation. We thereby also highlight the critical role of networks for the successful implementation of strategic change.

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