

CEO Charisma, Compensation, and Firm Performance

Original publication by Henry L. Tosi, Vilmos F. Misangyi, Angelo Fanelli, David A. Waldman, and Francis J. Yammarino

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When you think of a top-ranking member in a Fortune 500 firm, the image that would probably spring to mind is of someone really charismatic, full of life, someone whose innovation and energy has brought the company up to success. A previous study by Canella and Monroe suggested that “charisma and inspirational leadership are relevant because of their association with the *implementation* of strategic decisions, and not so much because of their relationship to the *choice* of strategies.” But how does one quantify that? Does having a charismatic CEO really predict firm performance? Are the lavish compensation packages generally awarded to CEOs who are perceived as highly charismatic justified?

Charisma is defined in the new study by Tosi, Misangyi, Fanelli, Waldman, and Yammarino as “based on the feeling of oneness that a person has with another, the desire for that feeling, or the personal attraction to be like the other: the stronger the attraction, the stronger the power.” The conductors of the study used a sample of Fortune 500 companies over a 10-year span, choosing 59 CEOs of substantial American firms in 26 industries. An initial random sample of 95 of the 929 firms listed on Disclosure in 1992 was chosen and questionnaires were sent to chart the various factors involved in corporate charisma.

Tosi et al. tested four hypotheses. First, “CEO charisma is positively related to firm performance,” meaning that the more charismatic a CEO is, the better their firm will do in the long run financially. Secondly, the scientists hypothesized that “the positive relationship between firm performance and CEO charisma is stronger under conditions of high uncertainty,” namely that the more unstable or unsure the atmosphere is at a company, the more important CEO charisma will prove and this will be demonstrated through company profits. The third hypothesis was that “CEO charisma was positively related to CEO compensation” – indicating that not only will the firm do better (their first hypothesis), but the CEO him/herself will also profit from his/her own charisma. Lastly, paralleling their second theory, they thought that the “positive relationship between CEO charisma and CEO compensation will be stronger under conditions of high uncertainty,” so the more uncertain the corporate environment, the more the CEO’s charisma will be rewarded financially.

One hundred and twelve responses were sent back describing 59 CEOs in 26 industries. Market- and accounting-based formulas were developed for measuring firm performance,

and the total CEO compensation was derived as the sum of the salary plus any bonuses the CEO would have received that year. Since it was over a substantial time-span, they also figured in long-term incentive pay, restricted and unrestricted stock grants, and stock options, etc. Uncertainty reflected two dimensions: perceived political uncertainty and perceived market uncertainty. Firm size, since they were all roughly even Fortune 500 companies, was the control variable.

Data from 1988 to 1997 were included, and regressions were created with Hierarchical Linear Modeling. Tosi et al., “found no significant direct relationships between CEO charisma and firm performance; yet, overall, charismatic CEOs extracted compensation premia in the form of higher total pay.” Further, under uncertain market conditions, charismatic CEOs “were able to boost the stock price, even though there was no evidence that these firms were internally managed better, as measured by return on assets.”

What are the ramifications of this study? The authors do stress “caveats” which shouldn’t be forgotten: that the sample size was relatively small, that obtaining data was extremely difficult, and that sometimes only top management members responded. Yet, the authors suggest that “boards should be a bit more circumspect in advocating charisma as a criterion for the selection of CEOs.” Apparently, charismatic CEO behavior is influential enough to pressure boards in ways that lead to higher pay in spite of firm performance.