

## **Star CEOs: Benefit or Burden?**

**By James B. Wade, Timothy G. Pollock, Joseph F. Porac, and Scott D. Graffin**

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Synopsis by **Veronica Pugin**, CMC '12

A star CEO is a CEO that has been recognized by the business media as exceptional and therefore has had their anonymity traded for an almost celebrity status. In this article, authors James B. Wade, Timothy G. Pollock, Joseph F. Porac, and Scott D. Graffin provide an analysis of the benefits and burdens that come with a firm employing a star CEO. This concept is analyzed through the means of case studies and examples of former star CEOs who have experienced this phenomenon. Wade et al. explain the list of benefits and burdens with an overwhelmingly higher weight present on the burden side and the vulnerability that comes with this public recognition. After observing the fact that star CEOs have such a high probability of falling from their celebrity status, the article emphasizes awareness of these burdens in order to find proper solutions to counter them.

The article begins by stating the fact that this phenomenon of star CEOs is an issue with which all successful CEOs are confronted today; they must maintain awareness. This advent of star CEOs is a result of society's celebrity culture and expanded media. The media has taken to turning formerly anonymous CEOs into figures in the public eye who will be observed more carefully. The simple benefit for these star CEOs is that they become favored because of this recognition. The ultimate challenge is for these individuals to stand up to the pressure to remain a star.

The authors delineate this dichotomy of benefits and burdens that star CEOs experience by offering examples of star CEOs who have experienced them. Due to the contributions of the business media, star CEOs fall under an increase of criticism and public scrutiny of their practices. As a result, Wade et al. argue that this inevitably leads to star CEOs fall. Examples of rapid falls included Kenneth Lay of Enron Corp., Dennis Kozlowski of Tyco International, and Stan O'Neil of Merrill Lynch & Co. An example of a more gradual fall was Jack Welch of General Electric Co. The authors use these examples in order to insist that this trend is continuous and CEOs and firms must find a way to answer to it.

The authors examine a star CEO's influence on the firm he or she manages. The benefit of the star CEO's management is an increase in the firm's credibility. This results in an increase of the company's economic value, positive investor and stakeholder views, more ease attracting better employees, better supplier relations, and more convenient capital acquisition. Also, an internal benefit is an increase in board confidence.

On the other hand, the list of burdens that result for a firm because of the star CEO is much longer than the benefits list. A major negative is the presence of hubris, which is the tendency for previously successful CEOs to tend to overestimate their abilities because of overconfidence. This leads them to try more risky initiatives that could harm the firm. Also, star CEOs tend to participate in "self-enhancing efforts" that do not contribute to the firm's success. These efforts

include speaking engagements. Such was the case for James Robinson III of American Express Co. and Carly Fiorina of Hewlett-Packard Co. and Compaq Computer Corp. The star CEO's presence also has the potential of undermining teamwork among the firm's other executives and employees because of her special treatment. A large salary inequality could lead to a lack of recognition of contributions of the firm's other employees. Robert Nardelli of The Home Depot Inc. fell victim to this because of his inability to build healthy relationships with his fellow employees.

The article continues by touching on the issue of whether firms should invest in paying such high salaries to attract star CEOs. This high compensation level results in an increase in investors' performance expectations. The celebrity CEO is held accountable for both successes and failures.

After presenting this list of observations, Wade et al. reveal how they conducted their research to obtain such information and the questions they worked to answer. They worked to evaluate if a star CEO increases the value for his firm and the relationship between star status and executive compensation. Wade et al. evaluated 282 companies that they found through the S&P 500 within the years of 1992 and 1996. They found the star CEOs through the CEO of the Year contest held by the *Financial World*.

The research results revealed that firms whose CEO won a medal from the CEO of the Year experienced an increase in stock market worth within three days after the award. However, in the long term the market shifted to undervaluing the firm. Wade et al. attribute this observation to the fact that with the awarding of the medal investor expectations increase and the star CEOs are not able to sustain these increased expectations. Also, regarding compensation, the newly awarded star CEO received an 11% compensation premium, but in the long term compensation rewards depended on performance and, "when performance was poor, star CEO's received lower compensation than CEO's who had never won a medal and achieved the same level of performance."

Finally, Wade et al. offer suggestions based on their assessment of this phenomenon of star CEOs. Newly dubbed star CEOs may experience initial excitement, but they must remain cautious of the long-term effects on their firm and the fickleness of the shareholders and board. Also, Wade et al. conclude that award-winning CEOs do not provide an increase in long-term profitability for a firm; therefore, firms need to reconsider the value of investing so much in high compensation premiums to attract these star CEOs. Boards must establish incentive-laden pay with the star CEO if they do pursue him. Ultimately, so that a CEO does not fall victim to the burdens of this phenomenon, he must remain focused on the structural basis of management.