

The factors behind the failure rate of CEOs

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What does it mean for a CEO to fail? Who is responsible? Is it purely about financial results?

CEOs are generally considered to have failed when they are unable to meet the expectations of their boards, shareholders and the market at large, or the company's stakeholders. This failure becomes official when a company confirms its decision to initiate proceedings for the CEO's departure. What are the primary factors leading to this dissatisfaction? What is the CEO's ability to react? And can the top executive be considered a "failure" when receiving a severance package worth millions?

Two decades ago, the research examining the CEO's career path concluded that around 90 percent ended their careers due to natural causes such as retirement, lack of fitness or death. Hence, only 10 percent were unexpected, caused by another type of factor.

The authors argue that over the past few years this trend has gradually led to shorter, less stable incumbencies lasting between three and five years, due to reasons such as greater internal and external competition, having a corporate vision that is overly focused on the present and, more recently, the global financial crisis — which has resulted in CEO turnover being twice that seen during times of prosperity.

Nevertheless, some studies show that half of CEO failures occur in good business environments. Thus, poor economic performance by an organization does not account for the majority of top-level firings.

According to IESE Prof. [Guido Stein](#) and Javier Capapé, in their study "[Factores de fracaso del CEO: mapa de un debate](#)" ("CEO Failure Factors: Mapping the Debate"), it is extremely

unlikely for these executives to meet the expectations of all the organization's stakeholders at all times. Therefore, their departure from the company can be caused by a wide range of factors.

The authors divide these factors into two main groups: endogenous and exogenous. This distinction works exclusively on a theoretical level as it is necessary to consider that the CEO's path is marked by various factors that interact with one another dynamically.

Endogenous factors

Endogenous factors are those where the CEO has some ability to step in and make changes. This intervention, however, does not always turn out for the best, given that in some cases CEOs can exacerbate the situation or even precipitate their exit from the organization. The primary factors are:

- *Compensation.* Compensation for a chief executive is given in a variety of categories, though it primarily includes shares in the company, fixed salary and bonuses. When there is no clear consensus regarding the effects of the CEO's compensation package, it is helpful to look at the importance of each format within the structure and whether it entails an incentive or a problem.
- *Origin.* Distinguishing CEOs as either insiders or outsiders, i.e., whether they were promoted from within the company or brought in as external hires. Numerous studies argue that under equal conditions an insider CEO is more likely to hold on to the position than an outsider, and that 70 percent of the businesses that achieve success have an internal top executive.
- *Being on the board of directors.* Having the CEO as a member of this executive body can be harmful or beneficial, depending on the situation. When poor results abound, CEOs may place greater responsibility on top-level executives in order to save their own job. In other studies, however, the internal promotion of the CEO is also tied to the organization's success.
- *Competencies.* Many studies argue that a lack of skills is the main reason for firing a CEO. In this respect, the authors explain that a CEO's talent declines sharply when changing companies and is not recovered until several years of adaptation have taken place; that a brilliant and rapid ascent does not ensure the CEO's talent; that these days CEOs are younger, less experienced, and the skills expected of them are no longer honesty and excellence but rather charisma and decisive leadership.

Exogenous factors

Exogenous factors are variables affecting the CEO's incumbency upon which the executive is powerless to intervene directly. Moreover, these are circumstances that can occasionally counteract the efforts made in relation to the endogenous factors. The primary factors are:

- *Demographic factors.* Variables such as age, origin, duration of the incumbency, the average age of the board members, and the specifics of the outgoing CEO and reasons for his or her exit.
- *Company size and years in business.* Larger organizations have higher turnover rates, since CEO replacement tends to be a routine, premeditated process. In small companies, turnover usually has a notable impact on the stock price, something that is occasionally conducive to external hires.
- *Sector.* Factors here include the sector's level of development, the diversity of financial performance and the number of existing businesses. The variables for each of these factors can contribute to both the departure and the survival of the CEO.
- *Characteristics of the board of directors.* Most studies consider that having a majority presence of external members spurs the demise of the CEO, if that entails an increase in the share price. With respect to size, it is generally agreed that a large board increases the chances of CEO turnover given that it is easier to create various interest groups.
- *Succession plans.* If the process is under way, it should be executed properly and not rushed, so as to avoid failure and ensure that the new CEO progressively acquires all of the necessary competencies.
- *Mergers and acquisitions.* Distinguishing between the synergistic variety, which translates into income for the merging businesses, and the disciplinary variety, in which the performance of the organization being acquired falls below the sector's average. Only in the latter case is it common to see the management team get replaced in order to improve the performance of the acquired company.

Although the authors underline the difficulties of providing valid conclusions about a common model of failure, their study examines the hits and misses of various prior studies and points out the need to carry on with the search and gear it toward qualitative analysis and the use of new methodologies. They feel that accomplishing more rigorous results requires longitudinal studies to analyze failure throughout the professional career of a specific CEO or the turnover history of a particular company.

The authors also suggest taking a more in-depth look at aspects such as the differences of

CEO failure in each sector, CEO competencies as an endogenous factor, the development of the stock market and the exact meaning of the term "failure."

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