Is a Powerful CEO Good or Bad for Shareholders?

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INTRODUCTION

Americans tend to admire powerful leaders. Powerful leaders wield influence over their organizations and external environments. They command considerable resources, both financial and nonfinancial, and direct these toward the pursuit of their objectives. In addition, they garner significant attention from internal and external constituents, which they leverage to amplify their impact and shape outcomes around them.

For these reasons, there is no shortage of profiles on powerful leadership. Countless books, articles, documentaries, and courses are devoted to the examination of executive power. These include not only biographies of well-known CEOs but also the leadership lessons of non-business leaders (political, historic, athletic, etc.) which are recast to apply to a managerial setting. Furthermore, periodicals regularly publish lists of powerful leaders, including *Time* magazine's "Most Influential People in the World," *Forbes*' list of "The World's Most Powerful People," and *Fortune's* "Most Powerful Women in Business."

Despite the attention, it is not clear the extent to which having a powerful CEO is beneficial to an organization and its shareholders. There are negatives as well as positives to executive power that must be taken into account to arrive at a reasoned assessment.

DEFINITION OF CEO POWER

Finkelstein (1992) defines power as "the capacity of individual actors to exert their will."[1] However, not all manifestations of power are the same. Finkelstein identifies four dimensions of power:

- *Structural power* is derived from the position that an executive occupies in the organizational hierarchy. CEOs hold considerable authority simply because of their formal position at the top of the corporation, which gives them decision making authority as well as superior access to inside information. Some extend this power by holding the dual title of chairman and CEO. Structural power allows a CEO to resolve disputes over strategy, acquisitions, organizational practices, and resource allocation in a manner consistent with his or her preferences. In this way, CEOs are able to give "the final word" on matters of disagreement.
- *Ownership power* reflects the degree of economic or voting interest that an executive holds in the organization. Executives are ultimately responsible to the owners of the corporation. Therefore a CEO with significant ownership interest will have more power than a CEO with no ownership interest. Ownership power manifests itself in the boardroom where corporate matters are decided (explicitly or implicitly) by vote.
- *Expert power* results from superior knowledge, experience, or access to information within the organization and in relation to the external environment. Expert power puts an executive in a position to resolve matters of uncertainty, thereby gaining influence over corporate choices. Expert knowledge is accrued through experience, education, and network connections within a relevant field. Expert power is often narrowly confined to a particular setting or industry.
- *Prestige power* is derived from the positive perception that others have of an executive based on his or her reputation. Prestige power might

accrue from educational background, affiliation with outside organizations or associations, government relations, personal relations with other "stars" or "elites," network connections, or prior success. Prestige power is perhaps the most intangible manifestation of power because it relies on the assumption that these associations give legitimacy to an executive's ability or judgment.

Note that these dimensions are not mutually exclusive, nor are they necessarily correlated. CEOs will have different degrees of power based on the combination of these dimensions that they manifest, as well as the importance of each to the relevant corporate setting.[2] Furthermore, CEO power can be exercised across a wide spectrum of decisions, including those regarding corporate strategy, operations, acquisitions, organizational design, culture, and governance.

THE DOWNSIDES OF POWER

The research literature on CEO power is mixed. According to Pfeffer (2010), "Studies on the effects of power on the power holder consistently find that power produces overconfidence and risk taking, insensitivity to others, stereotyping, and a tendency to see other people as a means to the power holder's gratification."[3]

Consistent with this, companies with a powerful CEO exhibit higher turnover among senior management, higher pay differentials between the CEO and senior management, and are more likely to engage in risky corporate activities.[4] Similarly, companies with a powerful CEO are less likely to have a formal succession plan in place, and powerful CEOs are more likely to influence the outcome when a succession event does occur. For example, Zajac and Westphal (1996) find that powerful CEOs play an integral role in the selection of their successor, and that they are more likely to steer the choice of a successor toward one who has similar characteristics to themselves.[5] This can make it very difficult to replace an entrenched CEO because there are no real alternatives for the board to consider.

Finally, the research indicates that companies with powerful CEOs tend to award higher executive compensation. For example, Belliveau, O'Reilly, and Wade (1996) find that CEOs with greater social status relative to other board and compensation committee members tend to receive larger compensation packages.[6] Similarly, Core, Holthausen, and Larcker (1999) find that compensation is higher when outside directors are appointed by the CEO. This suggests that directors are more willing to grant large compensation when they are beholden to the CEO for their position.[7]

THE UPSIDES OF POWER

Despite these negative findings, CEO power is an important leadership quality and offers many potential benefits to an organization. Bennis and Nanus (1985) explain that "power [is] the basic energy to initiate and sustain action translating intention into reality, the quality without which leaders cannot lead."[8] Pfeffer (1992) argues that "individual success in organizations is quite frequently a matter of working with and through other people, and organizational success is often a function of how successfully individuals can coordinate their activities. […] In achieving success in organizations, 'power transforms individual interests into coordinated activities that accomplish valuable ends.'"[9]

Adams, Almeida, and Ferreira (2005) find that firms with powerful CEOs have greater variance in firm performance (a type of risk for shareholders and employees). Powerful CEOs are identified in both the best and the worst performing companies that they examine. They conclude that powerful CEOs are better able to implement their decisions and that this has a positive effect when the CEO makes good decisions and a negative effect when the CEO makes bad decisions.[10]

Research also confirms that powerful CEOs are more likely to take actions to pursue their objectives, which can have a positive effect on corporate performance. Keltner, Gruenfeld, and Anderson (2003) find that powerful people are more likely to exhibit "approach" behavior—that is, taking actions to try to obtain what they want. They also exhibit decreased inhibition, meaning that they feel less subject to social restraints that otherwise limit behavior.[11] Self-inhibition can negatively impact future performance, and powerful CEOs might benefit from avoiding this tendency.[12] Also, powerful

CEOs are more likely to develop strong personal and professional networks, which can benefit their organizations by giving them and their companies access to important market information, management practices, and professional contacts.[13]

Finally, research suggests that individuals sometimes prefer to work in hierarchical settings, where power relationships are clearly defined. Tiedens, Unzueta, and Young (2007) find that individuals voluntarily create hierarchies when they are about to embark on a shared task. They argue that "people have an unconscious desire or motivation for hierarchically differentiated relationships […] and that people sometimes experience hierarchy as more enjoyable and productive than nonhierarchical relationships."[14] Similarly, Jost and Banaji (1994) find that people voluntarily disempower themselves to create or maintain hierarchical relationships.[15] In this way, having a powerful CEO clearly positioned at the top can contribute to stability and productivity in the organization.

WHY THIS MATTERS

1. A system of corporate governance is intended to protect shareholders from the self-interested behavior of management. The research literature clearly shows that having a powerful CEO creates the potential for him or her to abuse this position to extract personal benefits or engage in excessively risky activities. At the same time, the research also shows that power is often critical to the successful completion of tasks and the achievement of corporate objectives. To this end, powerful CEOs can ultimately be a success or a failure (see Exhibit 1). Are shareholders better or worse off with a powerful CEO?
2. While it is the role of the board of directors to oversee management, at some point the board must empower management to make decisions. Where should it "draw the line" between giving its CEO discretion and providing appropriate oversight? How much power is too much power? ■

[1] Sydney Finkelstein, "Power in Top Management Teams: Dimensions, Measurement, and Validation," *Academy of Management Journal* (1992).

[2] Furthermore, attempts to measure the impact of CEO power on an outcome of interest (e.g., CEO compensation) will depend on how the researcher defines power and the measures used to quantify power. For example, structural power might be measured (rightly or wrongly) by the titles held by an executive (CEO, chairman, etc.); ownership power might be measured by the size of equity stake or voting rights; expert power might be measured by prior experience, education, or external board seats; and prestige power might be measured by press mentions, quality of educational experience, and outside affiliations.

[3] Jeffrey Pfeffer, *Power: Why Some People Have It—And Others Don't*, (HarperCollins Publishers: 2010), p. 200.

[4] Chris Mann, "CEO Compensation and Credit Risk," Moody's Investors Service, Global Credit Research Report no. 93592 (2005); Olubunmi Faleye, Ebru Reis, and Anand Venkateswaran, "The Determinants and Effects of CEO–Employee Relative Pay," working paper (2012); Lucian A. Bebchuk and Jesse M. Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press: 2006); and Krista B. Lewellyn and Maureen I. Muller-Kahle, "CEO Power and Risk Taking: Evidence from the Subprime Lending Industry, *Corporate Governance: An International Review* (2012).

[5] Edward J. Zajac, and James D. Westphal, "Who Shall Succeed? How CEO/Board Preferences and Power Affect the Choice of New CEOs," *Academy of Management Journal* (1996).

[6] Maura A. Belliveau, Charles A. O'Reilly III, and James B. Wade, "Social Capital at the Top: Effects of Social Similarity and Status on CEO Compensation," *Academy of Management Journal* (1996).

[7] John E. Core, Robert W. Holthausen, and David F. Larcker, "Corporate Governance, Chief Executive Officer Compensation, and Firm Performance," *Journal of Financial Economics* (1999).

[8] Warren Bennis and Burt Nanus, *Leaders: The Strategies for Taking Charge* (Harper and Row: 1985), p. 6.

[9] Jeffrey Pfeffer, "Understanding Power in Organizations," *California Management Review* (1992); cites: Abraham Zaleznick and Manfred F. R. Kets de Vries, *Power and the Corporate Mind* (Houghton Mifflin: 1975), p. 109.

[10] Renee B. Adams, Heitor Almeida, and Deniel Ferreira, "Powerful CEOs and their impact on corporate performance," *The Review of Financial Studies* (2005).

[11] Note, however, that these tendencies can also be negative if the objectives of the person feeling disinhibited are not in the best interest of the organization. Dacher Keltner, Deborah H. Gruenfeld, and Cameron Anderson, "Power, Approach, and Inhibition," *Psychological Review* (2003).

[12] Frederick Rhodewalt and James Davidson Jr., "Self-Handicapping and Subsequent Performance: Role of Outcome Valence and Attributional Certainty," *Basic and Applied Social Psychology* (1986).

[13] See: Katherine J. Klein, Beng-Chong Lim, Jessica L. Saltz, and David M. Mayer, "How Do They Get There? An Examination of the Antecedents of Centrality in Team Networks," *Academy of Management Journal* (2004); and David F. Larcker, Eric C. So, and Charles C. Y. Wang, "Boardroom Centrality and Stock Returns," Rock Center for Corporate Governance at Stanford University Working Paper No. 84. (2010). Available at SSRN: http://ssrn.com/abstract=1651407.

[14] Larissa Z. Tiedens, Miguel M. Unzueta, and Maia J. Young, "An Unconscious Desire for Hierarchy? The Motivated Perception of Dominance Complementarity in Task Partners," *Journal of Personality and Social Psychology* (2007).

[15] John T. Jost and Mahzarin R. Banaji, "The Role of Stereotyping in System-Justification and Production of False Consciousness," *British Journal of Social Psychology* (1994).

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EXHIBIT 1 — MOST POWERFUL WOMEN IN BUSINESS (2004)

Rank	Name	Position	Company	Status in 2012
1	Meg Whitman	CEO	eBay	Resigned in 2008; Currently CEO of Hewlett Packard
2	Carly Fiorina	CEO	Hewlett-Packard	Terminated in 2004
3	Andrea Jung	CEO	Avon	Terminated in 2012
4	Anne Mulcahy	CEO	Xerox	Retired in 2009; Currently on boards
5	Marjorie Magner	Divisional CEO	Citigroup	Resigned in 2006; Currently on boards
6	Oprah Winfrey	Chairman	Harpo	Currently in same position
7	Sallie Krawcheck	CFO	Citigroup	Resigned in 2008; Resigned from Bank of America 2011
8	Abigail Johnson	President	Fidelity (Mutual Fund)	Currently President Fidelity (Parent Co)
9	Pat Woertz	EVP	ChevronTexaco	Currently CEO of Archer Daniels
10	Karen Katen	EVP	Pfizer	Resigned in 2007; Currently on boards

Source: “50 Most Powerful Women in Business,” *Fortune* (2004).