How Should You Pick CEOs / Leaders?
What Can You Learn From Successful CEOs?

by

Steven N. Kaplan
CEOs Matter, But Why?

- Given their leadership positions and compensation, seems likely that CEOs matter and have a significant impact on company success.

- Plenty of anecdotal evidence and stories about what CEOs do and how they matter.

- But, very little systematic, large sample, empirical work on how and why CEOs matter.
In this talk

- What do we really know about CEOs?
  - Economics and management literature.

- What my research does?
  - Assessments.
  - Characteristics.
  - Relation of characteristics to:
    » Hiring
    » Success

- What are the implications of the research?
Economics literature?

- Theorists model CEOs with different talents / abilities -- $t_i$ or $a_i$
- Those abilities map into firm performance. $P_i = f(a_i)$
  » Theorists provide no guidance at all concerning what those abilities or talents are.

- Empiricists (notably Bertrand and Schoar (2003)) find evidence consistent with different managers having different styles, different behavior, and different performance.
  » But empiricists provide few measures of ability or talent, focusing only on directly observable characteristics, such as CEOs’ “education,” “functional background,” and “age.”
Management Literature

- Yammarino et al. (2005) survey 348 publications with 17 leadership theories, ranging from the Ohio State Model to Charismatic Leadership and Romance of Leadership.

- Ulrich, Smallwood, and Sweetman (2009) summarize the current recommendations as “leaders need to have: innovative strategies […], forge long-term relationships with customers, innovate, execute, build high-performing teams, ensure accountability, manage people, communicate, engage others, create workforce plans, exercise judgment, have emotional intelligence, and possess an honorable character.”
  - No idea which of those are more important.

  - Argues against charismatic outsiders.
  - Firms should look more at insiders.
Popular literature?
- Most notable is Collins’ “Good to Great.”
  » Identifies “Level 5” leadership as building “enduring greatness.”
    ■ Compelling modesty.
    ■ Give credit to others / take blame on themselves.
    ■ Get the right people.

» Concern is that Collins identifies sample with large ex post bias.
  ■ CEOs of 11 companies have these characteristics.
  ■ There could have been 1011 such CEOs and 1000 could have failed.
No systematic, large sample work anywhere.
What do we do?

- We provide new evidence on CEO characteristics and abilities.
- Relate those abilities to hiring and firm performance.
Sample

- We rely on detailed assessments of over 300 CEO candidates in firms funded by private equity (PE) investors – both buyout (LBOs) and venture capital (VCs) investors.
  - Performed from 2000 to 2006 by ghSMART, a firm that specializes in assessing top management candidates.
  - Based on structured interviews with candidates of roughly four hours in duration.
  - Assessments are typically 20 to 40 page documents.
    » Include detailed information on the candidates’ life, from childhood through current job experiences.
    » Include assessments on more than 40 specific dimensions.
      - Coded as 4 = A or A+; 3 = A-; 2 = B+; 1 = B or less.
  - Assessments requested by PE firms -- VCs and LBO investors.
    » PE firm may or may not already have invested in the company.
    » CEO candidate may be incumbent or outside candidate.
What is assessed?

- Leadership
  - Hires A Players, Develops People, Removes Underperformers, Treats People with Respect, Efficiency, Network, Flexibility.

- Personal
  - Integrity, Organization, Calm Under Pressure, Aggressive but respectful, Moves Fast, Follows through on Commitments.

- Intellectual
  - Brainpower, Analytical Skills, Strategic Thinking / Visioning, Creative / Innovative, Attention to Detail.

- Motivational
  - Enthusiasm, Persistence, Proactive, Work Ethic, Sets High Standards.

- Interpersonal
  - Listening, Open to Criticism, Writing, Oral Communication, Teamwork, Persuasion, Holds People Accountable.
## What do assessments / ratings mean?

<table>
<thead>
<tr>
<th>Description of Characteristic</th>
<th>Description of a Candidate with a high score</th>
<th>Description of a Candidate with a low score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hires A Players</td>
<td>Sources, recruits, hires A Players.</td>
<td>Hires A Players 90% of the time.</td>
</tr>
<tr>
<td>Treats People with Respect</td>
<td>Values others, treating them fairly and showing concern for their views / feelings.</td>
<td>Teams would say Candidate is fair and respectful. Candidate describes performance in terms of team.</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Able to produce significant output with minimal wasted effort.</td>
<td>Candidate gets a lot done in a short period of time.</td>
</tr>
<tr>
<td>Teamwork</td>
<td>Reaches out to peers and cooperates with supervisors to establish relationship.</td>
<td>Recognizes the power of a strong team, and works collaboratively.</td>
</tr>
</tbody>
</table>
Classification of Ratings
Team / Interpersonal vs. Execution / Individual

- Leadership
  - I - Develops People, Treats People with Respect, Flexibility.
  - E - Removes Underperformers, Efficient.

- Personal
  - I - Integrity.
  - E - Aggressive but respectful, Moves Fast, Follows through on Commitments

- Intellectual
  - I -
  - E -
  - ? - Brainpower, Analytical, Strategic / Visioning, Creative / Innov., Attention to Detail.

- Motivational
  - I -
  - E - Persistence, Proactive / Initiative, Work Ethic,
  - ? - Enthusiasm, Sets High Standards (or H).

- Interpersonal
  - I - Listening, Open to Criticism, Teamwork.
  - H - Holds People Accountable.
  - ? - Writing, Oral Communication, Persuasion (or S?).
Question for you:
What matters more for performance?

- Execution / Individual:
  - Efficient, persistent, aggressive, removes underperformers; or

- Team / Interpersonal:
  - Develops people, teamwork, flexibility, good listener.
Outcome measures:
- (1) whether the CEO candidate is hired;
- (2) whether the PE firm invests; and
- (3) whether the CEO who is hired is successful.

Obtained data from two sources:
- Asked PE firms.
- Publicly available data:
  » Company websites, PE firm websites, Zoominfo, etc.
Success

- From PE firms:
  - Response for 146 of 316 CEOs.
  - Of 146, 106 hired.
  - Of 106 CEOs hired, PE firms provide answers on success for 81.
    - Of 81: 30 unsuccessful, 14 mixed, 37 successful.
  - Also asked PE firms re financial success of deal.
    » Of 68 with outcomes: 24 successful or very successful.
From PE firms and public sources:
- Of 316 CEOs, 224 hired.
- Public Success 1 (Certain):
  » CEO successful if led company to profitable exit.
  » CEO not successful if company bankrupt, sold or liquidated at a substantial loss, or CEO removed before exit.
  » CEO mixed if investment exited at modest return.
    ■ 67 unsuccessful, 5 mixed, 54 successful.
- Public Success 2 (Broad):
  » Same as above, but CEO also successful if company has received favorable press / higher valuation;
  » CEO not successful if company has unfavorable press.
    ■ 84 unsuccessful, 32 mixed, 92 successful.
Report LBO and VC separately.
- Different investors.
- Different return benchmarks by practitioners.
- Different company characteristics: mature versus young.
Overall Ratings Incumbents vs. Outsiders -

- Clear differences in ratings for outsiders versus incumbents.
  - Outsiders score higher than incumbents on most measures.
  - Many individual characteristics are significant.

- Consistent with at least two implications.
  - Outsiders considered when incumbents are not performing well.
  - PE firms upgrade the talent in the firms in which they invest.
**Correlations**

- Individual ratings for each candidate are highly correlated.

- Suggest that talent, ability, or skill have some general characteristic or quality spread across many dimensions.
Factor Analysis

- Large number and correlation of characteristics potentially problematic.
  - Large number may be difficult to use in one regression because of limited number of observations.
  - High degree of correlation means regression analysis will have problems and be difficult to interpret.

- Factor analysis extracts main components that determine variation in CEO characteristics.
  - For each candidate, loading on characteristics can be calculated.
Two strong factors:

- Factor 1 = general talent.
  » Loads positively on all characteristics.

- Factor 2 = team, interpersonal versus persistent, efficient, proactive.
  » Higher scores rated higher on “treats people with respect,” “integrity,” “listening skills,” “open to criticism,” and “team work.”
  » Lower scores rated higher on “aggressive,” “moves fast,” “persistent,” “proactive,” and “work ethic.”
We also separate the two parts of Factor 2:

- Alternative Factor 1: Persistence, Efficient, Proactive
  » Fast, Aggressive, Persistence, Efficient, Proactive, Standards

- Alternative Factor 2: Team, Interpersonal
  » Respectful, Open to Criticism, Listening Skills, Teamwork
Characteristics and Hiring

- Generally characteristics are positively related to being hired.

- For buyout CEOs, related to:
  - positively related to “aggressive,” moves fast,” “follow through on commitments,” “attention to detail,” “enthusiasm,” “persistence,” “proactive,” “open to criticism,” “teamwork,” and “persuasion.”
  - marginally negatively related to “analytical skills”

- Buyout firms seem to look for professional managerial skills.
For VC-firm CEOs.
- positively related to “integrity,” “brainpower,” “written communication,” “creative.”

VCs seem to look more for analytical horsepower and creativity.
Results for both LBO and VC stronger for outside hires.
- Outside CEO hiring significantly related to 20 of 30 individual measures.
- Incumbent CEO hiring significantly related to only 2 of 30.

In many cases, incumbents come with the company.
- I.e., PE firm can only invest if incumbent / founder stays.
Factors and Hiring

Estimate the relation of likelihood of being hired to the CEO candidate’s ratings on each of the three factors.

- Control for whether the candidate is an incumbent.

<table>
<thead>
<tr>
<th></th>
<th>All Deals</th>
<th>Buyout</th>
<th>VC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incumbent</td>
<td>0.503***</td>
<td>0.295***</td>
<td>0.444***</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.001)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>General Talent</td>
<td>0.099***</td>
<td>0.149***</td>
<td>0.102**</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.002)</td>
<td>(0.015)</td>
</tr>
<tr>
<td>Team versus Fast</td>
<td>0.004</td>
<td>0.014</td>
<td>-0.030</td>
</tr>
<tr>
<td></td>
<td>(0.864)</td>
<td>(0.739)</td>
<td>(0.430)</td>
</tr>
<tr>
<td>Factor 3</td>
<td>-0.006</td>
<td>-0.090*</td>
<td>0.036</td>
</tr>
<tr>
<td></td>
<td>(0.849)</td>
<td>(0.087)</td>
<td>(0.438)</td>
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<td>Year Controls</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>316</td>
<td>114</td>
<td>120</td>
</tr>
</tbody>
</table>
Factors and Hiring

- Being hired is positively and significantly related to the candidate’s loading on the first factor, which captures general talent.
  - Result holds overall and for both buyout and VC, individually.

- Regressions also indicate that incumbents are more likely to be hired by both buyout and VC-funded companies, holding talent equal.
  - Suggests that VCs and buyout investors place large value on firm specific or existing capital relative to general talent or skills.
  - Or, may need to keep CEO to make investment.
Alternative Factors and Hiring

When we separate team and execution factors, they both enter positively.

- Execution is significant for both LBO and VC.
- Team is significant for LBO.

<table>
<thead>
<tr>
<th></th>
<th>Full</th>
<th>Buyout</th>
<th>VC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incumbent</td>
<td>0.487***</td>
<td>0.289***</td>
<td>0.426***</td>
</tr>
<tr>
<td>(0.000)</td>
<td>(0.001)</td>
<td>(0.000)</td>
<td></td>
</tr>
<tr>
<td>Execution</td>
<td>0.074***</td>
<td>0.136***</td>
<td>0.078*</td>
</tr>
<tr>
<td>(0.004)</td>
<td>(0.003)</td>
<td>(0.069)</td>
<td></td>
</tr>
<tr>
<td>Team</td>
<td>0.045</td>
<td>0.098**</td>
<td>0.011</td>
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<tr>
<td>(0.120)</td>
<td>(0.044)</td>
<td>(0.824)</td>
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<tr>
<td>Year Controls</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
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<td>316</td>
<td>114</td>
<td>120</td>
</tr>
</tbody>
</table>
Characteristics and Success
Success and characteristics - Buyouts

- Success from LBO firms:
  - Significantly correlated with large number of individual measures:
    » “efficiency,” “organization and planning,” “follows through,”
    “analytical skills,” “attention to detail,” “persistence,”
    “proactive,” “sets high standards,” “holds people accountable.”
  - Individual CEO characteristics or skills do map into CEO success.
  - Skills seem to be predominantly of the execution variety rather than softer skills such as team building or listening.
Broader Success Measure:

- significantly correlated with “hires A players,” “efficiency,” “organization,” “commitments,” brainpower,” “analysis,” “persistence,” “proactive,” “high standards,” “writing,” “holds people accountable.”

- Largely consistent with those that only use the PE firm appraisals.

- Again, execution characteristics seem correlated with success.
**PEP Magnitudes are meaningful:**
Probability of success A/A+ ratings vs. lower
Buyout Firm Answers
Similar Results for Broader Success Measure

Prob. of success A/A+ vs. Below A Rating
[Buyout Firms and Public Info]
PE Success (Execution)
**Broader Success (Execution)**

![Chart showing various metrics such as efficiency, organization, commitments, persistent, and proactive, with data points indicating different levels of success.](image-url)
PE Success (Team / Interpersonal)
Broader Success (Team / Interpersonal)
Correlations of success and characteristics - VCs

- Success from VC firms
  - Significantly negatively correlated with “treats with respect,” “efficiency,” “flexible,” “attention to detail,” and “teamwork.”
  - Team talents associated with bad outcomes.

- Public Success and Broad Public Success similar results.
  - Efficiency and teamwork are always negative.
Problem is technology bust.

- Many of the CEOs hired in tech bust.
- When we control for year, the coefficients on
  » execution-related variables like “efficiency” become positive.
  » team-related variables remain negative.
Factors and Success

- Run regressions of success against factors.
- Control for
  - assessment year;
  - whether CEO is an incumbent.
**All executives**

- Success is strongly positively correlated with the general talent factor;
- Success is strongly negatively related to second factor.
- Incumbency not significant.

<table>
<thead>
<tr>
<th></th>
<th>(1) PE Measure</th>
<th>(2) Public Measure</th>
<th>(3) Broad Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incumbent</td>
<td>-0.009</td>
<td>0.120</td>
<td>0.088</td>
</tr>
<tr>
<td>(0.927)</td>
<td>(0.203)</td>
<td>(0.176)</td>
<td></td>
</tr>
<tr>
<td>General Talent</td>
<td>0.100*</td>
<td>0.106**</td>
<td>0.042</td>
</tr>
<tr>
<td>(0.094)</td>
<td>(0.030)</td>
<td>(0.189)</td>
<td></td>
</tr>
<tr>
<td>Team versus Execution</td>
<td>-0.200***</td>
<td>-0.101**</td>
<td>-0.067**</td>
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<tr>
<td>(0.000)</td>
<td>(0.025)</td>
<td>(0.042)</td>
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<tr>
<td>Factor 3</td>
<td>0.050</td>
<td>0.036</td>
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<tr>
<td>(0.376)</td>
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<tr>
<td>Constant</td>
<td>0.182</td>
<td>0.162</td>
<td>0.420**</td>
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<td>(0.124)</td>
<td>(0.539)</td>
<td>(0.014)</td>
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<tr>
<td>Obs.</td>
<td>81</td>
<td>126</td>
<td>208</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.339</td>
<td>0.165</td>
<td>0.080</td>
</tr>
</tbody>
</table>
All executives using alternative factors

- Success significantly positively related to execution factor.
- Success somewhat negatively related to team factor.

<table>
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<tr>
<th></th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
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<tbody>
<tr>
<td>Incumbent</td>
<td>PE Measure</td>
<td>Public Measure</td>
<td>Broad Measure</td>
</tr>
<tr>
<td></td>
<td>-0.041</td>
<td>0.081</td>
<td>0.087</td>
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<tr>
<td></td>
<td>(0.712)</td>
<td>(0.398)</td>
<td>(0.175)</td>
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<tr>
<td>Execution</td>
<td>0.189***</td>
<td>0.147***</td>
<td>0.079 **</td>
</tr>
<tr>
<td></td>
<td>(0.002)</td>
<td>(0.004)</td>
<td>(0.026)</td>
</tr>
<tr>
<td>Team</td>
<td>-0.127**</td>
<td>-0.030</td>
<td>-0.028</td>
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<tr>
<td></td>
<td>(0.019)</td>
<td>(0.511)</td>
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<tr>
<td>Constant</td>
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<td>0.237</td>
<td>0.428***</td>
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<tr>
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<td>(0.069)</td>
<td>(0.302)</td>
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<td>Obs.</td>
<td>81</td>
<td>126</td>
<td>208</td>
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<tr>
<td>R-squared</td>
<td>0.301</td>
<td>0.155</td>
<td>0.074</td>
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</table>
**LBOs**

- Execution-related abilities drive results.

<table>
<thead>
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<th>PE Measure</th>
<th>Public Measure</th>
<th>Broad Measure</th>
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<tbody>
<tr>
<td>Incumbent</td>
<td>-0.094</td>
<td>-0.009</td>
<td>0.036</td>
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<tr>
<td></td>
<td>(0.550)</td>
<td>(0.941)</td>
<td>(0.703)</td>
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<td>Execution</td>
<td>0.352***</td>
<td>0.272***</td>
<td>0.155**</td>
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<td></td>
<td>(0.004)</td>
<td>(0.001)</td>
<td>(0.011)</td>
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<td>Team</td>
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<tr>
<td>Year Controls</td>
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<td>Yes</td>
<td>Yes</td>
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</table>

<table>
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<tr>
<th></th>
<th>Obs.</th>
<th>R-squared</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>32</td>
<td>0.350</td>
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<tr>
<td></td>
<td>57</td>
<td>0.297</td>
</tr>
<tr>
<td></td>
<td>88</td>
<td>0.142</td>
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</tbody>
</table>
Summary

- New evidence on CEO characteristics and abilities
  - Novel data allow us to measure and classify individual characteristics and abilities.

- Abilities are generally positively correlated.
  - Two important principal factors:
    » General Talent; and
    » Team Player / Interpersonal vs. Persistent, Efficient, Proactive.
  - “Lamb versus Cheetah?”
We relate abilities to hiring, investment decisions, and outcomes.

Hiring:
- CEOs hired based on general talent.
- CEOs hired based on incumbency (firm specific knowledge and skill).
- Many individual abilities significant, particularly for outsider hires.
  » Both execution-related and team-related.
Success:
- Success related to general talent, particularly for LBOs.
- Success more related to execution skills, particularly for LBOs.
- Success not related to incumbency.
Implications

- Measures of CEO talent, skills, abilities appear to be meaningful.

- CEO talent, skills, abilities appear to matter.
  - Correlated with hiring, investment, and performance.
**Implications: What Determines Success?**

- General talent matters for success.
- Harder attributes, not softer attributes related to success:
  - Softer, team, and consensus attributes not associated with success.
  - Harder attributes, like “efficient,” “pro-active” and “persistent”, are associated with greater success.

Jack Welch  
Steve Jobs
- Success / performance more strongly correlated with hard skills rather than soft skills.
  - Soft skills overweighted in hiring?

PE firms (and GE) should try to hire Jack Welch, not Jeff Immelt:
  » “I think Jeff Immelt is the prototype of the modern chief executive… chief executives today need to have the whole range of ‘softer skills.’ They need to be good listeners …” Nocera, New York Times, June 9, 2007.
What about “Good to Great?”

- Appears consistent with

- Sometimes consistent with hiring the right people.

- Does not appear consistent with
  » Compelling modesty.
  » Give credit to others / take blame on themselves.
Peter Drucker (1967)? Effective executives:
- Utilize time efficiently. (Efficient)
- Focus on contribution. (Persistent / Follow through)
- Make strengths productive. (Efficient)
- Do first things first. (Proactive)
- Make effective decisions (Analytical skills).

Impressive correlation with significant variables for buyouts:
- From buyout firms: “efficiency,” “organization and planning,” “follows through,” “analytical skills,” “attention to detail,” “persistence,” “proactive,” “sets high standards,” “holds people accountable.”
- From all sources: “efficiency,” “organization and planning,” “aggressiveness,” “attention to detail,” “persistence,” and “proactive”.
**Why do we believe results?**

- CEOs who are persistent, efficient, and proactive:
  - get things done.
  - get the right people to work hard.

- CEOs who are not:
  - do not get things done,
    » even if they are good listeners, team players, etc.
  - do not get things done,
    » even if they have the right people because the better people get frustrated or even leave.
Why do we believe results?

Related research from Teresa Amabile.

- What really motivates workers? What makes them most enthusiastic about their work?
  » Incentives / Money?
  » Recognition?
  » Interpersonal support?
  » Progress?
  » Clear Goals?
Why do we believe results?

- Related research from Teresa Amabile.
  - What really motivates workers? What makes them most enthusiastic about their work?
    » Incentives / Money?
    » Recognition?
    » Interpersonal support?
  
  » **Progress**
    » Clear Goals?

  - Employees most positive when making progress, being helped to succeed.
  - Employees least positive when spinning wheels, encountering roadblocks.
Advice to Board Members in hiring at C-Level?

- In making hiring decisions, look for people with a history of PEP.
  - Persistent.
  - Efficient.
  - Proactive.

- Do not be misled by strong people skills, but no PEP.
Advice to CEOs?

- Be persistent, efficient, proactive. (Have PEP).
  - Do not impede progress.
  - Do not be indecisive.
  - Do not confuse others.
Thank you.

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