

Outside CEOs and Declines in R&D Productivity

Innovation is a critical driver of economic growth. Despite the importance of innovation, research and development productivity, the return companies see on investment in R&D, in recent years has declined nearly 65 percent. Forthcoming research in the Strategic Management Journal seeks to explain why company R&D productivity has declined by linking such declines to the hiring of outside CEOs in recent years. While outside CEOs bring general skills, such as leadership and financial management, they lack skills in the company's context and culture.

Key Takeaways:

- Companies with outside CEOs experience declines in R&D productivity compared to those who hire inside CEOs.
- Productivity declines are most drastic for companies heavily dependent on R&D, but can be lessened by hiring an outside CEO from a similar industry or with prior CEO experience.
- Long-term incentive compensation increases R&D productivity for inside CEOs, but not for outside CEOs.

Examining the R&D productivity of companies from 1992 to 2013, the authors found that companies with CEOs hired from outside the firm (within 2 years of being named the CEO) had lower R&D productivity. Further, these effects were more largely identified in later years of the outside CEO's tenure. R&D productivity was most significantly affected by companies who

depend on R&D to drive growth. Interestingly, the authors also found companies hiring outside CEOs with prior CEO experience or from a similar industry experienced lesser declines in R&D productivity. Finally, CEO long-term incentives increase R&D productivity for companies with inside CEOs, but were found to have no effect on those who hired outside CEOs.

In summary, the authors note that companies experience a decrease in R&D productivity following the hiring of an outside CEO. Despite this, the authors do not suggest that outside CEOs should be avoided, but rather than companies who rely significantly on R&D should consider the technological expertise of outside CEOs in the hiring process. The authors caution that it is important to understand how a CEO candidate's experiences will shape how R&D is managed and that significant negative impacts may not be identified early in a CEO's tenure, but may rather manifest after years of failed R&D projects and changes in R&D culture.

Source: Cummings, T. & Knott, A.M. 2018. Outside CEOs and innovation. Strategic Management Journal, DOI: 10.1002/smj.2792.

