RESEARCH BRIEF

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When Does the Board Blame the CEO?

Research soon to appear in the *British Academy of Management* shows that boards are more likely to dismiss CEOs of underperforming firms when the firms engaged in extreme resource reallocation (either greater or lesser than competitors) than similar performing firms that did not engage in such resource reallocation..

Key Takeaways:

- The likelihood that the board will dismiss the CEO when the firm performs poorly increases when the firm has invested resources that are different from the industry norm.
- The increased likelihood of CEO dismissal associated with extreme resource investments is further increased when the board has more industry experience.
- The increased likelihood of CEO dismissal associated with extreme resource investments is further increased when the board has more experience with the CEO.

Using data on 1,181 different CEOs from 868 firms in S&P 500 companies between 2001 and 2012 (excluding events occurring in financial or multi-segment firms and for events that occurred due to retirement, death, or resulted from takeovers or mergers) researchers found that when a firm's stock returns or profitability were worse than the median of competitors and the firm had invested at extremely different rates (either over- or under-investing) from competitors across advertising, research and development, plant and equipment newness, non-production overheads, inventory levels, and financial leverage, that the board was more likely to dismiss the CEO than similar performing firms that had not engaged in such extreme investment.

The research team also found more complex relationships. When a higher percentage of independent directors had experience in the same industry or when the percentage of time that independent directors had spent on the board with the current CEO were higher, the likelihood of CEO dismissal was even stronger for firms that invested in resources that were outside of the industry norms and performed poorly than when boards did not have those characteristics.

Their analysis statistically controlled for aspects of the firm (like size, ownership structure, and performance risk), board characteristics (like board size and independence), and the CEO (like CEO's shareholding, cash compensation), and market competitor characteristics.

Source: Louca, C., Petrou, A.P., Procopiou, A. (2019). When does the board blame the CEO for poor firm performance? Extreme resource reallocation and the board's industry and CEO experience. *British Academy of Management*, In press.