PRIOR EXPERIENCE WITH BOARD DIVERSITY AND OUTSIDE CEO PERFORMANCE

While research shows inside successions perform better than outside successions, little is known about why some outside successors succeed when others fail. An important job of outside CEOs is developing an effective relationship with the board of directors, with whom the CEO often has little prior interaction. Recent research in *Strategic Management Journal* suggests that an outside CEO's prior experience with a diverse board of directors compared to the level of diversity they experience within their own boards influences an outside CEO's effectiveness.

Key Takeaways:

- Prior experience with board diversity can significantly alter the effectiveness of an outside CEO.
- When outside CEOs have experience with more diversity compared to their current board, the CEO and directors are less likely to turn over in the CEO's first 3 years.
- Outside CEOs' ROA is 7.2% below average when prior experience is with less diverse boards.

The authors look at 188 outside successions, and compare the level of diversity on boards with whom the CEO had prior experience to the level of diversity on the CEO's current board. Results show that when the CEO's board is more diverse on a range of characteristics, both the CEO and individual directors are more likely to turn over in the CEO's first three years. Further, greater diversity of the CEO's board compared to prior boards also leads to below average ROA. Specifically, a 34% greater level of diversity on the company's board compared to the CEO's prior experience increases the likelihood of CEO and director turnover by 2.3% and 6.9% respectively. This same increase in diversity yields ROA 7.2% below industry average.

In summary, an outside CEO's ability to deal with board diversity is a significant influence on whether the transition will yield success for the company. Board diversity increases board perspective of opportunities and is likely to lead to greater board strategic oversight. CEOs who have not dealt with such dynamics may struggle in adapting to a board that operates differently than what they have experienced previously.

Source: Zhu, D.H. & Shen, W. (2016) Why do some outside successions fare better than others? The role of outside CEOs' prior experience with board diversity. *Strategic Management Journal*, 37: 2695-2708.