Organizational Dynamics (2016) 45, 278—282

Available online at www.sciencedirect.com

ScienceDirect

journal homepage: www.elsevier.com/locate/orgdyn

The "Turnaround Trap" of outsider CEOs: Causes and solutions for succession planning☆

Ayse Karaevli

"JC Penney names Apple's Ron Johnson as new CEO... The announcement sends JC Penney's stock up 17.5%"
(Los Angeles Times, June 15, 2011)

In a much anticipated event on January 25, 2012, Ron Johnson, the new outside CEO of JC Penney at the time, presented his bold turnaround strategy: "he was not going to just stabilize JC Penney, but was going to revolutionize it." He definitely did not disappoint investors who had boosted the company's shares six months previously with the announcement of Johnson becoming JC Penney's new CEO. Just over one year after his presentation though, Johnson was again in the headlines, but this time with a starkly different tone:

"JC Penney ousts CEO Ron Johnson after turnaround strategy fails, names predecessor to top spot... Ron Johnson's short-lived tenure as JC Penney's CEO will go down as one of the biggest flameouts in corporate America"
(Yahoo News, April 8—9, 2013)

The experience of JC Penney is not an isolated case. A recent study of CEO succession trends found that outsider CEOs have been forced out of office 44% more often than insiders have been during the past 10 years. Furthermore, compared to insiders, outsiders are nearly seven times more likely to be dismissed after a short tenure.

Why do outsiders who are hired by boards to undertake major transformations frequently fail to meet expectations? This fundamental query has been the subject of long debates in board meetings, water cooler conversations and discussions among academics in business schools. Based on our recent research, I bring clarity to this question, and offer managerial lessons on what companies can do to reduce the gap between anticipated and realized outsider CEO initiatives in the hope of decreasing the likelihood of costly outsider CEO failures.

Our research suggests that outsiders are usually selected when change is needed, and therefore, the choice of an outside CEO is often considered a "going in-mandate for change" from the board of directors. This results in the outsider being highly motivated to quickly generate substantial strategic change. However, our study reveals that the unsettling corporate circumstances that typically drive the selection of an outsider, *paradoxically* hinder the ability of this individual to generate this substantial strategic change in the early years of his/her tenure. On the other hand, outsider CEOs are able to generate a greater degree of change in a financially stable corporate environment and when they assume office after a planned retirement of the preceding CEO.

There is apparently a contradiction between the typical circumstances leading the board to select an outsider CEO and the circumstances enabling the new outsider CEO to implement strategic change. The critical constraining factors associated with poor performance and prior CEO dismissal, such as the strict board control, scarcity of financial resources, time needed to diagnose problems, and low trust and political ambiguity seem to significantly diminish the ability of the outsider CEO to undertake major changes. Together, all these unsettling conditions create the "Turnaround Trap" for outside CEOs, and serve as a barrier to change. The circumstances at JC Penney explain why Johnson was hired as CEO, and those same circumstances are also the major reason for his failure.

"... Given Johnson's track record, plenty of people are shocked by what's happened... But the circumstances at Johnson's previous companies were radically different from those at Penney... At Target and at Apple, Johnson was running with the wind, not against it."
("The Turnaround Trap", New Yorker, March 25, 2013)

☆ I thank Edward Zajac for his valuable comments and suggestions.

http://dx.doi.org/10.1016/j.orgdyn.2016.10.002
0090-2616/

The business press typically focuses on the simple distinction between inside versus outside CEOs. However, our research suggests that the industry origin of the outsider CEOs has significant implications for strategic change. Succession context can either enable or hinder the ability of CEOs hired from outside the industry more strongly than CEOs who are hired from outside the firm, but from within the same industry. My recommendations, directly drawn from the findings of our academic empirical research, taken together, challenge a number of assumptions and current practices on CEO succession:

- Use *proactive* outsider CEO hiring as a tool to break strategic inertia. For example, hire outside CEOs not as a reaction to poor performance; rather, do so before there are signs of a firm's performance deteriorating.
- Assess the organization's need for "double-outsider" status, that is, the need for a CEO from outside the firm and outside the industry.

RESEARCH

We conducted a detailed empirical examination of the strategic change consequences of CEO successions in eight U.S. industries (airline and seven branches of the chemical industry) between the years of 1972 and 2010. The industries selected and the long time-frame afford several contrasts and comparisons in terms of environmental stability/turbulence, growth, and structural changes due to industry jolts, enabling us to test the following major questions and generalize our findings to different contexts:

(1) When do firms typically choose outsider CEOs compared to insiders?
(2) Do outsider CEOs generate more strategic change compared to insiders?
(3) Under what conditions do outsider CEOs generate more strategic change than insiders do?

Our sample included 193 succession events involving 112 insider and 81 outsider successions in a 110 mid-sized and large public firms across 1958 firm-years. *Strategic change* is defined as a new CEO's ability to move the firm's strategy away from the status quo either with respect to (1) the firm's past strategic profile during the last year of the predecessor CEO's office (*strategic variation*), or (2) the industry norms, that is, the competitors' average strategic profile (*strategic deviation*). We examined six strategic indicators: advertising intensity (advertising/sales), research and development intensity (R&D/sales), plant and equipment newness (net P&E/gross P&E), nonproduction overhead (SGA expenses/sales), inventory levels (inventories/sales), and financial leverage (debt/equity). *CEO origin* was measured with whether a new CEO is promoted from internal ranks of the company (insider), or hired from outside the company (outsider), or hired from outside the industry (double-outsider). *Corporate stability/instability* was examined in terms of relative absence/existence of sociopolitical (i.e., prior CEO dismissal) and financial (i.e., poor firm performance) turbulence during the firm's transition from one CEO to another (see the *Selected Bibliography* for additional information about the original empirical research).

RESEARCH FINDINGS

When Do Firms Choose Outsider CEOs?

As Table 1 shows, firms are more likely to promote insiders to the CEO office in stable corporate circumstances. A higher fraction of insiders are promoted to the CEO office in ordinary retirement of the predecessor CEO and when the pre-succession firm performance is favorable. Outsider and double-outsider CEOs are more likely to be selected when the prior CEO is dismissed and the firm performance is low.

Do Outsider CEOs Generate More Strategic Change?

The magnitude of *strategic deviation* and *strategic variation* as a fraction of their respective sample means for insiders, outsiders, and double-outsiders were predicted by our empirical models estimated in our original study. The predicted changes, when firms' CEO choices switch from insiders to outsiders, and from outsiders to double-outsiders, are negligibly small, ranging from +3% to −1% which are statistically insignificant. This suggests that, controlling for all relevant factors, on average, there is no economically meaningful difference between insiders, outsiders, and double-outsider CEOs in terms of the magnitude of strategic change they implement in the post-succession period.

When Do Outsider CEOs Generate More Strategic Change?

Table 2 presents the magnitudes of predicted changes, which are obtained by using the partial derivatives of an econometric model, explaining the variation in strategic change using CEO origin, moderated by the nature of the predecessor CEO's departure and by the level of pre-succession firm performance, controlling for a large number of potentially confounding factors related to firm, industry and CEO characteristics.

As depicted in the representative graph below, these findings clearly suggest that outsider CEOs, particularly the double-outsiders, have a significant advantage over insider CEOs to move the strategy from the past, and from industry norms when there is relative corporate stability. On the other hand, insider CEOs are more successful in generating strategic change when corporate stability is low, i.e., under the conditions of poor firm performance and when the prior CEO was dismissed (Fig. 1).

Table 1 CEO Origin in Stable versus Turbulent Corporate Conditions

CEO origin	Prior CEO departure		Performance		
	Dismissal	Ordinary	Low	Medium	High
Insider	25	87	21	59	32
Outsider	25	41	21	30	15
Double outsider	6	9	6	6	3

Table 2 CEO Origin, Corporate Conditions, and Strategic Change

	CEO origin					
	Insider		Outsider		Double outsider	
	Strategic variation	Strategic deviation	Strategic variation	Strategic deviation	Strategic variation	Strategic deviation
Ordinary succession	−0.19	−0.49	0.03	−0.01	0.25	0.47
Firm performance	−0.22	−0.28	0.02	0.01	0.27	0.32

Summary of Findings

- Organizations are likely to select an outside CEO or a double-outsider when there is corporate instability.
- Outsider and double-outsider CEOs do not have a significant advantage over inside CEOs in generating strategic change.
- The corporate context plays a significant role as an enabler/barrier of a new outsider or a double-outsider CEO's ability to generate strategic change. Corporate instability inhibits an outsider or double-outsider CEO to implement strategic change.
- Inside CEOs implement a significantly greater degree of strategic change under the conditions of corporate instability, but fall significantly short of both types of outsiders in generating strategic change when the corporate environment is relatively stable.
- In a relatively stable corporate environment, double-outsider CEOs have a significant advantage over outsider CEOs from the same industry in generating strategic change.

Avoid the Turnaround Trap in Outsider Successions

Avoiding the Turnaround Trap requires a good understanding of how the trap arises in the first place. Both a typical outsider CEO selection process under turbulent conditions, and the post-succession circumstances that outsiders typically face, contribute to the trap. With regard to the CEO selection process, boards are typically under pressure to find a new CEO quickly when the firm's performance is low and the prior CEO is dismissed. This urgency can lead to bypassing a careful search process and selecting a new CEO with much less consideration. A board of directors usually interacts with an insider candidate on many occasions, and therefore, has a chance to observe that individual under different circumstances. However, boards usually face greater difficulties in acquiring this type of diverse information about external candidates. The urgency, and these information asymmetries, negatively influence a board's ability to effectively assess the fit between outsider candidates and the needs of their firm in turbulent times.

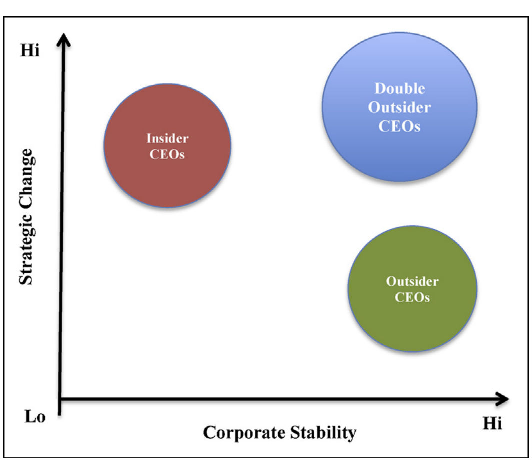

Figure 1 CEO Origin and Strategic Change under Different Degrees of Corporate Stability

With respect to the post-succession period, although the espoused mandate for strategic change is more formal, boards may have trepidation about giving the new outsider CEO, who is unfamiliar with the internal and — maybe external — environment of the firm, free rein in an unstable corporate environment. Other critical constraining factors associated with corporate instability, such as the scarcity of financial resources, the time needed to diagnose problems, and low trust and political ambiguity significantly diminish the ability of the new outsider CEO to undertake major changes. Together, all these unsettling factors can create the "Turnaround Trap" for outside CEOs, and hence, serve as a barrier to change.

In order to avoid the Turnaround Trap, firms may benefit from a delay in hiring an outsider CEO until the company's situation stabilizes. For example, at Delta Airlines, Gerald Grinstein, the chairman of the board, took over the airline after the forced exit of CEO Leo Mullin in 2004. Grinstein led the restructuring efforts to help the company emerge from bankruptcy. After the company's situation was stable in 2007, Richard Anderson was hired as CEO. He was a previous airline industry executive, from the United Health Group. Anderson made several unconventional moves that reengineered the airline business model, and set the company apart from the industry's norms in asset management (e.g., taking reservation systems in house), supply chain (e.g., acquiring an oil refinery), and international partnerships (e.g., with Aero-Mexico and Virgin Atlantic). These strategic changes, implemented in a relatively stable environment, brought the company significant performance gains, and the best airline awards for customer satisfaction. The company rejoined the S&P 500 in 2013.

Use Proactive Outsider CEO Hiring As A Tool to Break Strategic Inertia

There are a number of reasons why a new outsider CEO is likely to succeed in a stable corporate environment. If the firm is performing well, or if the company is emerging from the reign of a successful CEO, a board of directors typically has a better notion of the specific strategic changes they desire, and will be under less pressure to find a new CEO quickly. Consequently, they are likely to take the time necessary to conduct a comprehensive search for a skilled external CEO to implement desired change.

Archer Daniels Midland's (ADM) board hired a CEO in 2006 from outside the organization. This outside hire happened despite the excellent firm performance generated under the leadership of a powerful incumbent CEO, G. Allen Andreas. Andreas' family had led the company for four decades. The outside CEO was hired despite Andreas' publicly stated preference for an insider successor who would ensure strategic continuity. The outsider CEO, Patricia Woertz, an ex-Chevron executive, initiated change quickly with a strategy to reposition ADM, diversify the product portfolio in international markets, and involve the company with several sustainability activities around the world. In response to Woertz's initial strategic actions, one of the ADM directors stated: "there is an immediate sense this is not more of the same". Although these fundamental strategic changes initiated by the new CEO were viewed by many analysts as "a gamble" for a traditional company that was doing well financially, Woertz achieved sustainable growth at a mature multinational company during her successful 9-year tenure.

On the other hand, during turbulent times, insider appointed CEOs, because of their in-depth firm and industry-specific knowledge, have a deep understanding of the firm's culture and strategic needs. A strong internal powerbase can be effective in generating change geared toward fixing problems in a "troubled" company. The succession of the legendary CEO of Procter & Gamble (P&G), Alan Lafley, illustrates this situation. When Alan Lafley was appointed as the new CEO of P&G in June 2000, on the heels of Durk Jager's forced termination after only 17 months on the job as CEO, the markets were clearly disappointed. Lafley, who was a longtime insider with almost 25 years of tenure, had run P&G's Asia and beauty care operations. Nevertheless, he was not a known figure to investors. Under Jager's leadership, the company had issued three profit warnings in four months. The company stock price had plunged 30 percent in a single day. These turbulent circumstances led many, both inside and outside the company, to assume that an outsider CEO was needed to initiate bold changes to shake things up. However, with his in-depth understanding of the company's operations and culture, and with his intense focus on excellence in execution, he was able to raise aspirations, and in doing so, helped P&G to become a more consumer-driven and externally focused company. As a result, the company's performance increased significantly in the four years after Lafley took the reins. Today, he is considered as one of the most successful change agents in U.S. corporate history. He was even reappointed as the CEO of P&G in 2013 after his initial retirement in 2009.

Assess the Need for the "Double-Outsider Status" for the Optimal Search Scope

Searching outside the company, but within the industry, for a CEO may be insufficient if significant strategic changes are required. Outsider CEOs from within an organization's industry implement a significantly greater degree of strategic change compared to insiders in stable corporate environments. Yet, they fall short in generating the strategic changes achieved by industry outsiders. Industry tenure can lead to a narrowness of executive perspective, commitment to the status quo, and reduced access to diverse information. Firms led by long-tenured industry executives typically continue the same strategies, which conform closely to industry standards. Leadership skill and flexibility in strategy execution are critical for bringing about fundamental corporate change. These attributes are higher in CEOs who have cross-industry experience.

In summary, taking a chance on double-outsider CEOs can pay off in stable companies that desire changes that challenge conventional industry standards. For example, in 2011, diamond producer DeBeers' hired its first outsider CEO, Philippe Mellier, who had 30 years of experience in the transportation industry. He had no mining or diamond experience. Nevertheless, during an environmental shift toward a competitive market environment, he was expected by the board to initiate strategic changes to "project the company into the future". He transformed an old monopoly company into a competitive player under the circumstances of the shifting landscape of the diamond industry. Another example is Burger King hiring CEO, Daniel Schwartz, even though he had no fast food experience. In the face of expected dramatic changes in the fast food industry, including shifting customer demands, and serious challenges from non-traditional competitors that include Starbucks and Dunkin' Donuts, Schwartz took a "start-up approach" and implemented major changes in the company's business model, rejuvenating this aging company.

CONCLUSION

Outsiders are more likely to be hired under turbulent conditions when change is needed, but they are also more likely to get trapped in those unstable corporate environments. On the other hand, corporate stability enables outsider CEOs to bring about strategic change. Boards should not wait for signs of deteriorating firm performance to give serious consideration to hiring an outside CEO candidate. Hiring an outsider CEO is a method for generating proactive change to break strategic inertia, rather than a panacea for deep-seated company problems in tough times. Insider CEOs are more effective in generating change geared toward fixing problems in troubling companies.

These recommendations are somewhat inconsistent with the stereotypical depiction of outsider CEOs, who take risky and bold action in highly turbulent circumstances. This may indeed explain why boards so often choose CEOs that are bound to fail. The implications are significant. Boards should refrain from concentrating solely on outsider CEO candidate skills and past track records. Rather, they should consider the constraining effects of the succession context in tough times on an outsider CEO.

SELECTED BIBLIOGRAPHY

The research presented here builds on the academic research that the author conducted with Edward Zajac: A. Karaevli and E. J. Zajac. "When Do Outsider CEOs Generate Strategic Change? The Enabling Role of Corporate Stability", *Journal of Management Studies*, 2013, 50(7), 1267—1294. The current paper has focused and elaborated on the empirical results with the most important managerial implications, and discussed the implications of empirical findings regarding unresolved managerial issues. Readers interested in exploring more theoretical and methodological details and sophisticated econometric analyses could look at the published academic paper.

The phenomenon of "Turnaround Trap" has been previously introduced by J. Surowiecki in the business press ("The Turnaround Trap", March 25, 2013, http://www.newyorker.com/magazine/2013/03/25/the-turnaround-trap). The current paper seeks to explain the causes and solutions of this phenomenon by building on the findings of the author's academic empirical study cited above.

For information on other corporate examples in the text, see the following accounts: A, Chang., "J.C. Penney Names Apple's Ron Johnson as its New CEO", (June 15, 2011) http://articles.latimes.com/2011/jun/15/business/la-fi-0615-jcpenney-ceo-20110615; A. d'Innocenzio, "JC Penney Ousts CEO Ron Johnson, Ullman Returns", (April 8, 2013) http://new.yahoo.com/jc-penney-ousts-ceo-ron- 020924276.html; Associated Press. "A Look Back at Some Major CEO Flameouts" (April 9, 2013), http://new.ahoo.com/look-back-major-ceo-flameouts-204758841.html; R. Anderson, "Delta's CEO on Using Innovative Thinking to Review a Bankrupt Airline". *Harvard Business Review*, 2014 (December), 43—47, for Delta Airline's new strategy and performance results; K. Westbrook (the ADM director who led its CEO search) in G. Burns "Bringing New Energy to ADM" (December 29, 2006), http://articles.chicagotribune.com/2006-12-29/news/0612290114_1_adm-renewable-fuel- biofuel; J. Birger, "Patricia Woertz, the Outsider", (October 2, 2006), www.money.cnn.com; R. Blitstein, "Patricia Woertz and the New (Old) Thing", (June 4, 2009), www.tr.scribd.com; W. MacNamara, "De Beer's New Chief Relishes Luxury of Time, *Financial Times*, (July 26, 2011), http://www.ft.com/cms/s/0/efa761ba-b79e-11e0-8523-00133feabdc0.html; S. Becker, "Burger King's Evolution: Why BK Won't Go Out Like Blockbuster", (August 6, 2014), http://wallstcheatsheet.com/business/burger-kings-evolution-why-bk-wont-go-out-like-blockbuster.html.

For outsider dismissal rates, see K. Favaro, P-O Karlsson and G. L. Nielson. "2014 Study of CEOs, Governance, and Success", www.strategyand.pwc.com; for information difficulties in the *outsider CEO selection* process, see E. J. Zajac. "CEO Selection, Succession, Compensation and Firm Performance: A Theoretical Integration and Empirical Analysis". *Strategic Management Journal*, 11, 313—330, and Y. Zhang, "Information Asymmetry and the Dismissal of Newly Appointed CEOs: An empirical Investigation". *Strategic Management Journal*, 2008, 29(8), 859—872. For more extensive discussion on the boards' greater scrutiny to chief executives' actions and decisions in tough economic times, see Karlsson, P-O and Nielson, G. L. "CEO Succession 2008: Stability in the Storm". *Booz and Co Report*, 2009, 55 (Summer), 3.

For a more comprehensive research results on the continuity versus change implications of CEO successions and successor origin, see S. Finkelstein, D. C. Hambrick, and A. A. Cannella, Jr. *Strategic Leadership: Theory an Research on Executives, Top Management Teams, and Boards*, (New York: Oxford University Press, Inc, 2009), 190—194; A. Karaevli "Performance Consequences of New CEO 'Outsiderness'": Moderating Effects of a Pre- and Post-Succession contexts", *Strategic Management Journal*, 2007, 28(7), 681—706; For a more extensive discussion on the inertial effects of industry tenure, see D. C. Hambrick, M. A. Geletkanycz, and J. W. Fredrickson "Top Executive Commitment to the Status Quo: Some Tests of Its Determinants". *Strategic Management Journal*, 1993, 14(6), 401—418. For the details of the rationale, conceptualization and operationalization of the Strategic Change measures and/or for more extensive literature on the strategic choice and strategic change consequences of CEO successions, in addition to our original academic study, see M. Carpenter, "The Price of Change: The Role of CEO Compensation in Strategic Variation and Deviation from Industry Strategy Norms", *Journal of Management*, 26/6 (2000): 1179—1198; S. Finkelstein and D. C. Hambrick, "Top Management Team Tenure and Organizational Outcomes: The Moderating Role of Managerial Discretion". *Administrative Science Quarterly*, 35/3 (1990): 484—503; Y. Zhang, "The Presence of a Separate COO/President and Its Impact on Strategic Change and CEO Dismissal". *Strategic Management Journal*, 27/3 (2006): 283—300; Y. Zhang and N. Rajagopalan, "When the Known Devil is Better than an Unknown God: An Empirical Study of the Antecedents and Consequences of Relay CEO successions", *Academy of Management Journal*, 47/4: (2004): 483—500; Y. Zhang and N. Rajagopalan, "Once an Outsider, Always an Outsider? CEO Origin, Strategic Change, and Firm Performance", *Strategic Management Journal*, 31/3 (2010): 334—346.

Ayse Karaevli is Professor of Corporate Management & Change at the WHU - Otto Beisheim School of Management, Germany. She received her doctoral degree from Boston University, and completed her post-doctoral studies at the Kellogg School of Management at Northwestern University. Her research is in the broad area of strategy with a focus on strategic leadership and change, and executive careers. Her work has appeared in management journals including Strategic Management Journal, Journal of Management Studies, Journal of Vocational Behavior, Sloan Management Review, and Organizational Dynamics and in several books. (WHU-Otto Beisheim School of Management, Burgplatz 2, 56179 Vallendar, Germany. E-mail: ayse.karaevli@whu.edu).