

# “The Strategic Value of a CEO”

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# The Strategic Value of a CEO

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## Abstract

The search for sustainable competitive advantage appears to be shifting from traditional market strategies to a consideration of internal organizational factors. Unlike market strategies, internal organizational attributes may both lead to a performance advantage and be sustainable. As the firm's primary strategist, the Chief Executive Officer (CEO) is ultimately responsible for the firm's corporate strategies and for selecting alliance partners. Historically, the prevailing assumption has been that managerial resources (value) are embodied in the experience, judgement, knowledge, skills, and expertise that managers bring to the firm – in other words, managers' human capital. Recent studies suggest that this assumption is incomplete as executives' extra-organizational networks also affect organizational strategy and performance. This study attempts to provide explanations of how top executives' experiences and perceptions influence organizational decisions that generate competitive advantage; and it also raises questions regarding the worth of the CEO.

**Key words:** leadership, strategy & policy, CEO, compensation.

## Introduction

According to recent studies, market globalization and increasing competition have created dynamic environments in which strategies designed to ensure competitive advantage are quickly eroded by imitation, counter-attacks, and weakening entry barriers. This suggests that markets are moving more towards perfect competition, and therefore a sustainable competitive advantage is hard to achieve.

The search for sustainable competitive advantage appears to be shifting somewhat from traditional market strategies to a consideration of internal organizational factors. Unlike market strategies, internal organizational attributes may both lead to a performance advantage and be sustainable. According to Barney (1991), for an internal characteristic to provide a sustained competitive advantage, it must be valuable, rare, and imperfectly imitable. In recent years a number of internal firm characteristics like the company's culture, total quality management (TQM), institutional memory of skills and processes ("black art"), and trusting relationships between top management and employees have been considered to produce a sustainable advantage.

As the firm's primary strategist, the CEO is ultimately responsible for the firm's corporate strategies and for selecting alliance partners. Historically, the prevailing assumption has been that managerial resources (value) are embodied in the experience, judgement, knowledge, skills, and expertise that managers bring to the firm – in other words, managers' human capital (Becker, 1964). Recent studies, however, suggest that this assumption is incomplete as executives' extra-organizational networks, the CEO social capital, also affect organizational strategy and performance (Mizruchi, 1996).

The compensation of CEOs of major U.S. corporations is another related subject that has received wide attention. There has recently been considerable concern and criticism over the enormously inflated executive salaries, even in situations where the companies' performance has been mediocre. A study made by a U.S. Senate subcommittee, based on compensation surveys by KPMG Peat Marwick, showed that the difference between typical CEO pay compared to typical manufacturing workers' pay is much greater in the U.S. than in any major industrialized country. The spread is 2½ times greater than the difference between CEO pay and workers' pay in Japan or

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Germany. Those comparisons are for base salaries only, excluding bonuses and options. Executive compensation has risen far more rapidly than employee salaries and worker wages, which is creating a social problem in the U.S., a growing percentage of struggling lower and middle class families and a small, extremely wealthy, top executive class.

Forbes and Business Week publish annual issues devoted to CEO compensation, and in the 1992 presidential campaign, candidate Clinton called for limits on the tax deductibility of CEO compensation packages. In 1994 Congress decreed, in the form of a tax law, that anything more than \$1 million is too much. Straight salaries beyond that sum for top executives at publicly held corporations are not deductible by the corporation that pays them. There's a loophole in the law for performance-based pay (like options), but the law still stands as a stark statement about pay equity (Dolan, 2000).

The 2002 Enron and Global Crossing scandals revealed that top executives had manipulated earnings and concealed debts in order to collect bonuses and execute stock options to enrich themselves by tens or hundreds of millions of dollars, while the companies were plunging into bankruptcy. As a result of those disclosures, several proposals have been made to change accounting rules, enact legislation, or issue Securities and Exchange Commission (SEC) regulations to:

- require companies to show the cost of stock options as a deduction from profit;
- eliminate off-the-books partnerships or require full disclosure of them;
- give employees the same opportunity to sell their stock holdings as executives have;
- provide shareholders with an opportunity to vote on executive compensation, particularly the generous “golden handshakes” given to executives who quit or are fired for poor performance,
- link bonuses to profits – properly accounted profits, not *pro forma* profits – rather than to stock performance. While profits can be “managed” they are less subject to wide fluctuations than share prices. The latter can move up or down for reasons completely unrelated to management’s performance, such as general market optimism or pessimism, changes in the prime rate, and negative or positive political or economic forecasts.

The increasing importance of leadership at the strategic level, as an important ingredient for the revitalization of organizations, is the primary motive for firms granting increases in CEO pay and rewards. Strategic management theorists have become increasingly concerned with top level executives and their effects on strategy formulation and firm performance.

The purpose of this study is twofold: first, it examines how top executives’ experiences and perceptions influence organizational decisions that create business competitive advantage; and, second, it attempts to provide explanations regarding the worth of a CEO.

### **The Value of CEO Trust**

One of the means to a sustainable competitive advantage for organizations is through cultural change from a control-oriented to an involvement-oriented management culture based upon mutual trust. According to Argyris and Schon (1964), the degree of trust and respect between management and employees has a direct bearing on the performance of the organization. In a climate of low trust, employees vent frustration and aggression by attempting to break management rules and 'get away with it,' or by setting inappropriate goals which are not conducive to firm performance. Alternatively, when trust for the leader is high, employees may be more willing to see the legitimate needs of the organization. Mayer et al. (1995) argued that trust leads to risk taking behaviors such as delegation and empowerment on the parts of leaders, and organizational citizenship behavior and enhanced individual performance on the part of subordinates.

Trust has been shown to influence such behaviors as communication, problem-solving and low employee turnover, leading to organizational effectiveness. When a general manager is more trusted, employees are more likely to believe that their contribution to the organization, both direct and indirect, will be recognized and rewarded in some way.

Mayer et al. (1995) argued that three factors – ability, benevolence, and integrity – provide unique perceptual perspectives from which to consider the CEO's trustworthiness. First, to trust the manager, an employee must perceive that the manager has the ability or competence to accomplish the focal task. Second, if the employees believe their general manager will go out of his/her way on their behalf they are more likely to trust him/her. According to Korsgaard et al. (1995), this belief is influenced in part by the extent to which the leader's behavior is relevant to the individual's needs and desires. Finally an employee's perception of the general manager's integrity involves the employee's belief that the general manager adheres to a set of principles that the employee finds acceptable. Factors of such consistency, a reputation for honesty, and fairness contribute to the employee's perception of general manager integrity. Even an employee does not like a particular managerial decision, the employee may still trust the general manager if he/she believes that the general manager is just, honest and fair (Davis et al., 1995).

The tenuous bonds between managers and employees have been weakened by the shift in the U.S. from an industrial society to an information society. When most workers were employed by manufacturing companies, such as steel or automobiles, they were closely tied to a single industry and to limited geographic locations. A steel worker's options were pretty much limited to working in steel companies, most of which were located in two or three states. An auto company assembly worker's options were pretty much limited to working in an automobile plants, which are clustered in certain regions.

With the change to an information society, these trade union or guild limitations disappear. A computer programmer or information technology specialist can find work in a wide variety of industries anywhere in the U.S. or even abroad. In fact, an increasing number of skilled professionals (estimated at 20%) work at home and rarely appear at the employer's place of business. Thus the occupational cords that tied a worker to a specific company or group of companies have been weakened or broken. If employees consider their managers to be unfair, unreasonable, ineffective, or undesirable in any way, those employees can far more easily change employment than their fathers or grandfathers could do. This places a greater importance on the CEO's human relations talents.

### **The Value of CEO Experience and Perception**

As competition becomes more global and the costs and complexity of technological development increase, firms are establishing networks of strategic alliances. Alliances help to limit performance risk associated with technological development.

As the firm's primary strategist, the CEO is ultimately responsible for the firm's cooperative strategies and for selecting alliance partners. The top executive of a firm can be expected to enact or construct a shared understanding of the situation that is used to determine which alliances are most beneficial to the firm. The cognitive orientations executives use when they assess technological alliance opportunities are reflected in (1) their age, educational background, and work experience; (2) their perceptions of their companies' emphasis on technology and risk; and (3) their perceptions of their companies' success in previous technological collaborative efforts (Tyler, 1998).

When top executives decide to investigate potential technological alliances, they must collect information that will allow them to evaluate and compare various options. The CEO, as a complex information-processing system, tries to assess potential technological alliances rationally based on the cognitive understandings he/she has established through their experience, and so, their ability to consider all the information they have is limited.

In general the information processed by executives as they individually assess potential technological alliances can be categorized as information related to organizational opportunities and information related to organizational threats. CEOs in general are more sensitive to information that is associated with threats than to information associated with opportunities, and so, their personal experience and perceptions of their firms, influence the assessment of potential technological alliances (Dutton and Jackson, 1987).

According to behavioral decision theory, executives develop their own cognitive representations of reality called schema or mental understandings which are stored and then used as templates to explain and interpret events (March and Simon, 1958). These mental structures allow executives to select the information that is most relevant in a given situation and process quickly and efficiently. This ability to attend to information selectively is important because more information is typically available for processing than individuals are cognitively capable of considering. Due to these limitations of the human condition, it is very important for executives to be capable to learn to amplify relevant information and attenuate irrelevant information to clearly assess threats and opportunities. According to behavioral decision theory and cognitive research, the information that executives attend to and the weightings they give to various pieces of information is influenced by the cognitive or mental understanding they have developed over time (Russo and Schoemaker, 1989).

### *Age*

CEO's age is highly correlated with total work experience, organizational tenure, and industry tenure. Hambrick and Mason (1984) maintained that firms with younger managers would be more inclined to pursue risky strategies than firms with older managers. These authors also suggested that younger managers are more likely to seek growth through more novel and innovative strategies in an effort to seize perceived opportunities than older managers (Geletkanycz et al., 1998). A study by MacCrimmon and Wehrung (1990) of more than 500 top executives offered support for these beliefs. In the study, the most mature executives were also the more risk averse (maturity was a combination of age, seniority, and number of dependents). Because technological strategic alliances are typically perceived as risky relative to other methods of growth, such as acquiring technology already developed, it is argued that older executives will be more conservative in their assessment of potential technological alliances than younger executives.

In the youth oriented U.S. society, the value of experience and mature reasoning is often considered of far less importance than being perceived to have a youthful outlook, that is, being in tune with the latest fads, fashions, and trends. The major consumers for most goods and services are in the 24 to 45 age group or, in some cases, the 14 to 45 age group. Persons in their 50s or older are generally considered to be less active consumers. Therefore they can be ignored for marketing purposes, except for products designed specifically for the elderly population. Advertising is aimed primarily at the youth market, including those who would like to think of they are as youthful.

### *Education*

Education may be considered indicative of one's knowledge and skill base (Hambrick and Mason, 1984). Helmeier (1993), CEO of Bellcore and the Industrial Research Medallist for 1993, noted the importance attributed to the technical training of CEOs in the 1990s. He argued that the role of top executives has changed from operator to that of designer and emphasized the need for executives to understand not only the technology that drives their business today, but also the technology that will change their business in the future. His arguments suggest that top executives with a more complete understanding of the technological base of a company will be better able to position the firm proactively to compete more effectively in the future than executives without an understanding of the firm's technology. On the other hand, executives without a technical education can be expected to be aware of the fact that they are less capable of assessing technological alliance alternatives than their colleagues with a technical education and, therefore, should be more conservative in their assessments.

Technical training fosters in individuals a long-term commitment to a deeper understanding of relevant technologies and prepares an executive to predict, comprehend, and anticipate long-term change and opportunities. It also enables the executive to require fewer pieces of information to form an opinion about a technological trend. According to Hambrick and Mason (1984), executives with only a formal management education are more likely to pursue short-term performance goals at the expense of innovation and long-term asset building, and therefore, business schools

are not effective at developing risk-taking tendencies, but rather teach future managers risk avoidance (Geletkanycz et al., 1998).

Of course, the emphasis on short-term performance is greatly influenced by the manner in which U.S. companies raise capital and compensate their executives. Young companies frequently raise money from venture capital firms that closely follow quarterly earnings. Such firms push for steadily increasing quarterly results so that they make an Initial Public Offering (hopefully within 5 years or as soon as possible) and cash out their investment. Larger companies raise money on the stock market where stockbrokers, analysts, mutual fund trustees and pension plan managers follow the company's results closely, quarter by quarter. They are quick to buy and sell on the basis of short term performance. Consequently, a CEO is under pressure to show short term gains, even if his own wish is to aim for greater profitability on a long term basis.

Moreover, executives' bonuses are normally based on annual profits. This naturally influences the executive to maximize short term results. He might not be around in the long term. A major part (if not most) of a senior executive's compensation may be in the form of stock options. There is a strong temptation to cash out the options when the stock is high. It would take a selfless executive to sacrifice near term stock gains in favor of building the company's long range performance – perhaps after his options have expired.

Thus, the manner in which U.S. companies are financed, and the way in which top U.S. managers are compensated, both work to mandate the executives' attention on short term results. These factors are different than in countries such as Japan and Germany, where much more of corporate financing is in the form of long-term bank loans from banks that have an equity interest in the companies and other institutional connections as well. Moreover, Japanese and German executives typically have far less compensation in terms of bonuses and stock options that are dependent upon short term earnings (Riess, 2000).

### **The Value of CEO Networks**

In the recent years, empirical evidence has emerged to show that CEO social capital, the executives' external ties, plays a crucial role in shaping strategy, as well as overall firm performance. Previously viewed as a tool used by CEOs to gain power and status over the board of directors and its compensation-setting process, CEO networks constitute a valuable organizational resource.

Organizational resources, defined as "strength the firm can use to conceive of and implement their strategies" (Barney, 1991), play a central role in competitive success. Resources take many forms, including financial, physical, human and intellectual. Often overlooked, management also constitutes a critical organizational resource. Research suggests that senior managers, in particular, have an important impact on organizational strategy and performance (Finkelstein and Hambrick, 1996).

Historically, the prevailing assumption has been that managerial resources (value) are embodied in the experience, judgement, knowledge, skills, and expertise that managers bring to the firm, in other words, manager's human capital (Becker, 1964). Yet recent studies suggest this assumption is incomplete as executives' extra-organizational networks also effect organizational strategy and performance. Directorship networks, in particular, are observed to be among the most beneficial to firms (Mizruchi, 1996).

Directorate ties help to reduce the level of uncertainty surrounding external resource dependencies. They allow firms to secure critical resources, often on more favorable terms. Through participation in directorate networks, executives are also able to scan the broader environment for new trends and developments, and have greater access to strategic information and opportunities. They gain firsthand insight into the interests, operations, and agendas of other firms. Such information is critical because it enhances the firm's ability to formulate and implement strategic policies that effectively negotiate environmental contingencies (Geletkanycz et al., 1998).

Finally, executives' external directorate ties confer important legitimacy and status benefits. Executives service on outside boards, particularly prestigious ones, is a mean of signaling managerial, and thus, organizational quality (Spence, 1974).

To sum it up, executives' external networks convey numerous benefits of considerable strategic value. To access those benefits, however, firms must first successfully recruit and retain the individuals possessing those vital linkages. It is important to note that directorship ties are properties of the individual executive, and his/her network counterparts. While their benefits may extend to the firm, the ties themselves reside with the individual. What's more, they cannot be easily traded or transferred to another (Burt, 1992).

The more diversified the firm is, the greater the need for the benefits of CEO external linkages appears to be. By definition, diversified firms must contend with a broader array of buyer, supplier, competitor, other groups, and the assorted threats they impose. Accordingly, the scanning and information-processing demands faced by diversified firms are significantly greater than those encountered by single or dominant-business entities. At the same time, the broader operating base associated with diversification imposes an elevated need for a diversity of physical, capital and human resources. Executives' directorship linkages aid in each of these areas. They lend greater certainty and stability to resource transactions (Pfeffer and Salancik, 1978), provide access to rich and timely external information (Burt, 1992), and also stimulate the outside support needed to sustain operational viability.

According to Haunschild (1994) directorate linkages offer relevant benefits to diversified firms that often rely on acquisitions as a vehicle of growth. The directorate networks not only channel information concerning acquisition opportunities, but they aid in the determination of appropriate premiums. Further, the social connections embedded in executives' networks smooth the acquisition process, defeating negative external perceptions and potential resistance to acquisition activity (D'Aveni and Kesner, 1993).

In conclusion, executives' networks constitute an important strategic resource. If firms are to attract, retain, and develop executives capable of creating and leading flexible organizations, they should consider not only professional backgrounds and work experience, but also executives' ability to establish and maintain external networks. Similarly, individual executives looking to enhance their managerial effectiveness and career mobility should examine their professional networks. As organizations become increasingly interconnected and firms move toward network-based models of competition, executive social capital is likely to become an increasingly important factor in strategic leadership (Geletkanycz et al., 1998).

### **The CEO's New Role in The Global Economy**

Business globalization has been a great resource of uncertainty, as well as opportunity for CEOs. According to Gartner (2001), there are three reasons for the almost intractable challenges global CEOs face. The difficulty of running a multinational company during a time of tremendous technological change, the great uncertainties of the global environment, and the need for the CEO to be both a business leader and a global statesman concerned with everything from environmental protection to rules for cyberspace.

Corporate competition has been dramatically changed by information technologies and globalization, altering what CEOs must do day to day. It's not just that the competition is so fierce but that it is qualitatively different. In the 1980s the American manufacturers faced the Japanese companies that were mastering quality, inventory control and speed to get products to market. Today, however, the race is less against some identified competitor and more for markets that don't yet exist; for consumer needs that have not yet been identified and for young talent whose creativity has yet not been discovered.

Financial markets on the other hand are more ruthless. CEOs must focus on long-term imperatives when the markets are demanding financial results quarter by quarter and are unforgiving when it comes to even the hint of lagging performance. They are also required to ensure strong growth, hit or exceed precise targets convert the company to be Internet-savvy and have operations that are scalable (Engardio, 2001).

Never before have CEOs faced such pressure in their strategies. They have to design solutions that will make their companies global but attuned to each and every major market around the

world, to make the Internet part of the company's structure without altering elements of traditional culture. Difficult dilemmas also include balancing the focus on short-term gains in shareholder value with a longer-term strategy, bringing the Internet into every aspect of business, while also cutting expenses and personnel and construct compensation packages for top talent, now when stock options are less attractive.

Today the CEOs are forced to play a number of roles. At one time they need to be commanding general, coach, cheerleader; brilliant strategist and shrewd tactician; financially astute and technically savvy, a down-to-earth communicator in front of their employees and a charismatic star on CNBC. On top of all this, they are under the public spotlight for their policies toward employees, working conditions, human rights, helping the communities and conserving the environment (Gartner, 2001).

Already, intense political pressures have caused companies to alter their policies toward workers, the environment and social responsibility. But this is just the beginning of the second stage of globalization in which the political and social issues will present challenges equal to dealing with trade competition or the Internet.

### **What is the CEO Worth?**

In 1980, CEO compensation was 42 times that of the average worker. In 2000, it was 531 times (Business Week, 2002). In 1999 the average package for a CEO at 50 out of the largest corporations was \$9.3 million, up from \$2.8 million in 1990. The big shift has been the rise of options and long-term compensation, that in 1999 represented 70% of remuneration. *Forbes* magazine found 12 chief executives recruited within the last three years who at March 1, 1999 stock prices have scored pay packages worth at least \$100 million (Dolan, 2000).

Why the boards offer so much? For a host of reasons there's a shortage of so called rock-star bosses who can bring a company instant credibility. And the hired executives are not leaving the safe confines of a big company without a huge upside.

According to Harris and Helfat (1997), the external recruited CEOs earn greater initial compensation than internal successors for reasons related to skills. When executives switch firms, they forgo the future value of their firm-specific skills in their old firms, and also bear risk connected to the lack of firm-specific skills in their new jobs. To induce an executive to switch firms, therefore, a firm may have to pay a premium up-front to an external successor.

In mid-1998, Robert Knowling, 44, the number two executive at U.S. West was offered the top job at then private Covad Communications, a DSL provider, for \$400,000 in salary and 5% equity. After six months, in January 1999, Covad completed a public offering that made Knowling's stake in Covad worth \$310 million (Forbes, 2000).

The 1990s-frenzied atmosphere has even produced billionaire CEOs. Robert Zollars, 42, president of Cardinal Health, a \$25 billion medical product distributor, got an even bigger share of Neoforma, a business-to-business marketplace for medical products. In July 1999, he received immediately exercisable options to buy 13% of the company for 10 cents per share, and a loan from Neoforma to buy the options; along to a sounding \$750,000 salary. Neoforma went public in late January, six months after he got there, and now his share is worth \$3.3 billion. George Conrades, 61, was a former top GTE and IBM executive before he joined Internet software firm Akamai Technologies in April 1999. Six months later Akamai went public. Conrades' 6.5 million Akamai shares are now worth \$1.8 billion (Forbes, 2000).

According to Dolan (2000), new companies, not yet public, typically offer to a prospective CEO equity stake between 5% and 10%. Often the options are immediately exercisable, though the executive usually can't sell the stock right away. Companies are so eager to lure executives that they lend them money to buy the initial stake.

Why is a CEO worth 5% of a company? A rock star executive can create the excitement to get a public offering off the ground. A brand name CEO also attracts other talented executives. And, of course, the right CEO can do what the founders want and are willing to pay for -- to turn a start-up into a real company.

The 1990s booming stock market drove the executive compensation in the nine-digit era. But the prized options represent the downside to escalating pay packages. The increase in overhang, the percentage of a company's stock allotted for options, isn't necessarily good for shareholders. It may align the CEO's fortune with the shareholders', but sooner or later the dilution will hurt earnings, and shareholders will pay the price (Dolan, 2000).

*... whatever happened to performance-based pay?*

In 2001 the stock market seemed to have lost faith that the America of the 1990s had devised a magic formula for gliding through booms and busts with minimal damage, just as they lost faith in Asia's master technocrats in 1997.

What were the flaws of the late 1990s' American stock market boom? The only yardstick of success that really mattered to companies and many stock analysts was profit growth. CEOs, confident that they could boost profits by at least 15% annually, perpetuated the myth of perpetual high growth. E-business giants such as Cisco Systems, Oracle, and Hewlett-Packard assured Wall Street that they could meet 25% to 30% profit gains even though it was clear that the telecom and computer sectors were cooling off fast (Engardio, 2001).

A number of studies showed that sustained high profit-growth was very rare. A recent analysis by the National Bureau of Economic Research in Cambridge, Mass., noted that the median profit growth rate of American companies, adjusted for inflation and dividend payouts, was just 3.5% over the past decade. That was in line with historical trends and not too much higher than annual growth in gross domestic product (Engardio, 2001).

Yet many CEOs, including those of giant conglomerates, still behave as if they must meet unrealistic targets, even in today's economic conditions. So they're putting a meat-ax to core businesses. In the meantime, top executives are earning pay packages, including stock options, in the tens of millions of dollars annually. As one popular business publication recently lamented:

*"The cultural perception of the CEO in America has taken a dramatic turn for the worse. Heroes to millions in the '90s, CEOs are increasingly seen as villains. Once they were lionized as larger-than-life generators of wealth for the many or creators of wondrous new technologies. Now they are portrayed as exploiters of the system who are out for themselves. Even the President has felt the need to chastise CEOs about the need for responsibility. Enron, it appears, has tarred the entire managerial class" (Business Week, April 22, 2002).*

Worse still, CEO pay is becoming increasingly disconnected to CEO performance, making compensation appear even more unfair to the average person. Ford Motor CEO Jacques Nasser was fired last year (2001) when his company reported a \$5.45 billion loss. Many workers were laid off and salaries for nearly everyone left suffered. Yet Nasser was given about \$20 million in compensation for the year, depending on how well Ford stock does in the future. Who wouldn't hate CEOs after this?

Jill Barad, former CEO of Mattel, was given a reported \$50 million termination award despite the fact that Mattel had suffered badly under her direction. Her acquisition of the money-losing software business Learning company for \$3.6 billion, which was later given away for no cash payment, was a classic blunder. Yet she profited very handsomely, being generously rewarded despite the fact that Mattel's stock declined more than 50% – to about \$11 out of \$28 – in the three years that she ran the company (Los Angeles Times, 2001).

Much of the problem of seemingly irrational compensation stems from the structure of the boards of directors of large publicly held companies. In theory, the board represents the shareholders. Its role is to determine the goals of the company, to set major policies, and to hire, direct, compensate, and terminate the CEO and senior officers. In practice, the boards are often the creatures of the CEOs. The boards more often than not relinquish their authority to set policy and allow the CEO a free hand. They become rubber stamps.

This subordination of the board to the CEO arises from the board's membership. Typically as many as half of a corporation's board members are vice-presidents of the company, subordinates of the CEO. They are unlikely to challenge their boss' authority on vital issues. The re-

maining board members are frequently CEOs from companies on whose boards the CEO himself sits. The unspoken understanding between such interrelated board members is, "Don't question my actions and I won't question yours." Which board members actually owe their loyalty to shareholders? Usually none.

*... but wait, some good news?*

Lately, however, there has been increasing pressure on CEOs to justify their hefty paychecks. This pressure is coming from stockholders, Wall Street, the general public, and the U.S. President himself. President Bush has used public shame to remind CEOs of their responsibilities and exhorted that Corporate America's leaders should act to restore the public's faith in the managerial class.

Shareholder power is increasingly being concentrated in institutions such as pension plans and mutual funds. These institutions are beginning to change from being passive investors. They are exercising their power to influence corporate policy. The massive State of California employees pension fund, for example, is increasingly taking an activist role and is making its voice heard in the board rooms and shareholders meetings of companies in which it holds substantial blocs of stock. When shareholder power was diffused over millions of small investors, management could (and did) generally ignore the shareholders wishes, while paying lip service to them. No longer. The large, sophisticated, institutional shareholders have the ability and the inclination to exercise power (Gordon Riess, 2000).

Mattel Inc. revised its policy on severance awards after shareholder criticism of the enormous award that the toy company gave to former top officer Jill Barad. Under the new rules, Mattel in most cases won't grant a departing executive severance benefits that "significantly exceed" the requirements of the officer's employment contract, according to a proxy statement filed with the Securities and Exchange Commission. In setting severance, the committee also will consider the effect of the exit package on the morale of other employees.

In May 2002, the CEO of E-Trade, Christo Cotsakos, announced that he was giving back \$21 million in 2001 compensation (of nearly \$80 million) after shareholders registered their discontent by selling E-trade stock. According to E-Trade President Mitch Caplan, "we are clearly in a difficult environment, and investors clearly reacted to this... and we wanted to make sure that we got our message out loud and clear that we heard investors and were responding to their concerns" (Los Angeles Times, 2002). In addition to returning part of his compensation, Cotsakos also signed a contract for the next two years that provides an annual bonus based on the company's performance, but no base salary.

Whether the above examples are signs of a good trend to come is something that we shall have to wait and see.

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