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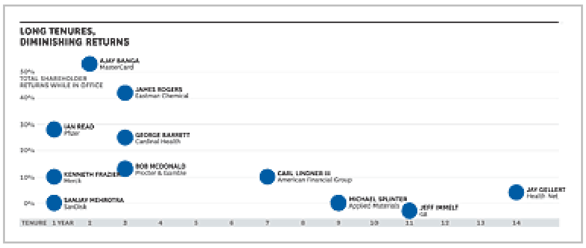
Long CEO Tenure Can Hurt Performance

by Xueming Luo, Vamsi K. Kanuri, and Michelle Andrews

It's a familiar cycle: A CEO takes office, begins gaining knowledge and experience, and is soon launching initiatives that boost the bottom line. Fast-forward a decade, and the same executive is risk-averse and slow to adapt to change—and the company's performance is on the decline. The pattern is so common that many refer to the "seasons" of a CEO's tenure, analogous to the seasons of the year.

New research examines the causes of this cycle and shows that it's more nuanced than that. We found that CEO tenure affects performance through its impact on two groups of stakeholders—employees and customers—and has different effects on each. The longer a CEO serves, the more the firm-employee dynamic improves. But an extended term strengthens customer ties only for a time, after which the relationship weakens and the company's performance diminishes, no matter how united and committed the workforce is.

We studied 356 U.S. companies from 2000 to 2010. We measured CEO tenure and calculated the strength of the firm-employee relationship each year (by assessing such things as retirement benefits and layoffs) and the strength of the firm-customer relationship (by assessing such things as product quality and safety). We then measured the magnitude and volatility of stock returns. All this allowed us to arrive at an optimal tenure length: 4.8 years.



The underlying reasons for the pattern, we believe, have to do with how CEOs learn. Previous research has shown that different learning styles prevail at different stages of the CEO life cycle. Early on, when new executives are getting up to speed, they seek information in diverse ways, turning to both external and internal company sources. This deepens their relationships with customers and employees alike.

But as CEOs accumulate knowledge and become entrenched, they rely more on their internal networks for information, growing less attuned to market conditions. And, because they have more invested in the firm, they favor avoiding losses over pursuing gains. Their attachment to the status quo makes them less responsive to vacillating consumer preferences.

These findings have several implications for organizations. Boards should be watchful for changes in the firm-customer relationship. They should be aware that long-tenured CEOs may be skilled at employee relations but less adept at responding to the marketplace; these leaders may be great motivators but weak strategists, unifying workers around a failing course of action, for example. Finally, boards should structure incentive plans to draw heavily on consumer and market metrics in the late stages of their top executives' terms. This will motivate CEOs to maintain strong customer relationships and to continue gathering vital market information firsthand.

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