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INITIAL PAY OF NEW CEOS IN TURNAROUND SITUATIONS

New research in the *Strategic Management Journal* shows that decisions about pay for CEOs that are hired to lead a turnaround are crucial not only to attracting the right candidate, but also for motivating them once they are onboard. The author argues that high pay is necessary to compensate CEOs for the especially strenuous and emotionally difficult task of helping a firm recover from a downturn. Furthermore, CEOs have a natural tendency toward growth and diversification, but turnarounds demand very different strategies like retrenchment and restructuring. A pay premium can motivate CEOs toward more appropriate strategic action.

Key Takeaways:

- New CEOs hired into turnaround situations tend to demand more pay in general, and a higher proportion of performance-based pay.
- Higher pay premiums for CEOs in turnaround situations yield cost cutting and strategic focusing strategies which bring greater success.
- Pay premiums are most effective for CEOs with more industry experience, but more prestigious CEOs engage in appropriate strategies more often regardless of pay.

Using data from 196 CEOs hired into medium and large established S&P 1,500 companies between 1990 and 2003, the author examined the level and consequences of new CEO pay. Results show the CEOs in the study received a pay premium when their assignment required a turnaround. When the pay premium was higher, the new CEO was more likely to engage in downsizing, cost-cutting, and increasing strategic

focus, which improve performance under these circumstances. The effect was stronger for CEOs with more experience in the hiring firm's industry.

Contrary to his expectations, the author reported that pay premiums were not more effective for prestigious CEOs, defined as those who had previously held high-level posts in prominent firms. Instead, these leaders engaged in retrenchment and refocus regardless of pay. The author speculated that prestigious new CEOs may be more concerned about their reputation, and they were therefore more likely to take appropriate action even with a lower pay premium. He suggests that hiring CEOs with more prestige may substitute for higher pay in trying to encourage the tough measures that are required for a successful turnaround.

The author notes that future research is needed to understand whether these findings are sensitive to different types of turnover situations, and to investigate the importance of the circumstances that led firms to experience a downturn in the first place.

Chen, G. (2015). Initial compensation of new CEOs hired in turnaround situations. *Strategic Management Journal*, 36, 1895-1917.



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