Deloitte.

What sets outperforming CEOs apart and how boards can help

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Contents

Executive summary **05**

Section I. Introduction **06**

Literature review 07

Objectives and sample framework 08

Section II. Sample inferences **11**

Section III. CEOs and performance analysis **16**

The theoritical framework 16

Determining the metrics and benchmarks 16

Constructing performance scores 18

Limitations of the study 20

Results and insights 20

CEO appointment and company performance 20

CEO stability and company's equity premium 25

CEO performance and tenure 25

Time taken to reach the peak performance 27

Section IV. Business strategies and performance **28**

Section V. Key findings and recommendations **32**

References **36**

Connect with us **37**

Executive summary

Does leadership affect a company's performance? This question has been of great interest to investors, board members, analysts, and researchers. Our interest in understanding the significance of the CEO's role in influencing company performance encouraged us to conduct a study of a select few Nifty 50 companies (as listed on June 2021) that experienced CEO transitions over the past 1.5 decades since 2005. Although the term 'leadership' can be attributed to an array of CXO roles, we focused only on CEOs—the highest-ranking executive and the face of an organisation—as they are responsible for driving critical corporate decisions to maximise business value.

While our analysis led us to conclude that CEOs do significantly influence a company's performance, it also provided additional insights on what made CEOs outperformers and how boards can make a difference. Our sample of newly appointed CEOs within the period of the study had very little female representation. An overwhelming majority were appointed internally and transitioned due to retirement, contract expiry, promotion, or transfers, suggesting possibly a planned and gradual succession by companies. Newly appointed CEOs were slightly younger in service companies relative to those in manufacturing companies and the former performed better than the latter. That said, the outperformers were significantly older than the rest and the majority of them came from manufacturing companies.

To complement our findings, we examined key business strategies that the outperforming CEOs pursued in the first three years after their appointment. A few distinct commonalities emerged from our analysis. The first three years of the best-performing CEOs were marked by the adoption of a mix of strategies, which had an equal emphasis on the engine room activity, customer satisfaction, and scale expansion, amongst others, and continuity in strategies of their predecessors that worked. We also noticed considerable attention being paid to improving the health of the balance sheet. These outstanding CEOs continued their exceptional performance beyond the first three years until the end of their tenure.

Findings from our empirical research offer a few propositions for CEOs and board members that could improve their companies' performance. We believe a company's success rests on two shoulders. The first shoulder is that of the CEOs who are critical to driving a company's performance. That requires exploring a mix of strategies developed methodically and executed consistently, without losing sight of profitability and stakeholders' interest. The second shoulder is that of boards whose responsibilities do not end with choosing the right CEO. They are also responsible for providing clarity on performance expectations (both in the short and long term), ensuring a smooth transition, and giving the CEOs the necessary time to implement the board's vision.

What sets outperforming CEOs apart and how boards can help

Section I. Introduction

Every organisation undergoes leadership transitions in its lifetime; many of these changes are natural transitions as old leaders pave the way for new leaders when their contracts end or they retire. Sometimes, the changes are abrupt because of resignations and in rare cases, removals. Moreover, a slowdown in business, shifts in resources and ownership, rapid transformation in technology, changes in consumer preferences, and shifts in market dynamics compel organisations to re-evaluate and re-plan their business models. Many organisations respond to these transitions through leadership and organisational changes. It is believed that a new leader with fresh perspectives and ideas will improve agility. This is necessary to adapt to rapidly changing situations, maintain its repute and market share, and achieve sustainable success.

Leadership changes often result in speculations and anxiety amongst investors and other stakeholders as they associate it with a shift in an organisation's strategy, philosophy, culture, and environment. These shifts can have implications on the organisation's top line and bottom line. There are concerns over whether the transition will be smooth, the organisation will cope with the change, and the incoming leader will perform better than the outgoing leader. As a result, with every transition, investors focus on the incoming leaders' past performance and his/her familiarity with the industry dynamics. That explains why organisations undergoing a change in leadership highlight past achievements of the incoming leader to assure investors and other stakeholders.

That leads us to the question: How does leadership impact an organisation's performance?

We initiated our research to answer this question, but the study also revealed several other interesting findings. This helped us offer some of our recommendations based on empirical observations, especially for the board members of Indian companies. Given the complexity associated with a CEO succession and organisations' reputation at stake, the board plays quite an important role in managing transitions. It has to ensure the selection of the right person and a smooth transition of the new CEO. The board must also lay the groundwork for the newly appointed CEO to succeed. This involves engaging with the incoming CEO to familiarise the person with the company's culture, policies, and dynamics; and specify a mix of short-term and long-term objectives for the CEO. In other words, the outcomes of succession are almost always a shared responsibility.

Literature review

The topic has been extensively studied and debated for decades. The sheer volume of research done on the role of a leadership/leader as a change agent in managing organisations and addressing organisational changes highlights the importance and inquisitiveness around this topic. Literature suggests a significant improvement in top line and bottom line performance through direct and indirect effects of leadership (Lord and Maher, mid-1990).[i] In 1991, Barrick et.al demonstrated that high performers added a further US$25 million in value to an organisation during their tenure compared with average performing executives.[ii] A 2010 Harvard Business School study, with more than 10,000 observations, found the CEO impact to be significant, accounting for about 14 percent of the variance in company performance, although it varied across businesses.[iii] A more recent study based on a large 20-year sample from the US suggests that perhaps 38 percent of the performance variation at the firm level can be attributed to CEOs' decisions and influence on their firms' performance.[iv]

To explain how leadership influences performances, researchers linked an organisation's performance with its internal quality parameters, such as culture and employee engagement. Research conducted by Harvard in 1993 linked good leadership with an organisation's culture, staff loyalty and productivity, value add to customers, and finally customer satisfaction and trust.[v] These parameters contributed significantly to organisations' bottom line. Similar findings were reported by Gallup in its 2006 analytical research.[vi] In its two subsequent reports, business units from the top-quartile of the financial performance reported higher engagement scores. This also explained their higher earnings per share.

On the contrary, Stanley Lieberson and James O'Connor (1970) suggested that leadership may have a marginal impact on an organisation's performance with success being limited to some industries.[vii] In an empirical analysis, they concluded that situational and constrained factors, such as industrial and company differences, have far more influence on organisational financial performances. Meindle et.al. (in 1985) proposed the theory of 'romance of leadership' that talks about the tendency (amongst followers) to overestimate the role of leadership as the most important factor for the success or failure of an organisation while neglecting external circumstances.[viii] They also discussed other implicit leadership theories where individual biases emerge amongst followers in their perceptions of leadership in response to a focal leader's behaviour.

Several subsequent studies have argued that although leadership may influence organisational success or failure, organisational performance, in reality, is an interplay of a wide variety of complex, temporal, situational, and interrelated factors. According to a Harvard study, one-third to one-half of the new chief executives fail within their first 18 months. One of the reasons is the company board makes an incorrect choice by 'overestimating a candidate's abilities and potential or hiring a leader whose skill set does not match the

requirements.[ix] That said, external factors, such as economic events, political and social structure, and industry and sector-specific developments shape a company's performance that a leader may have no control over. Events such as a steep rise in commodity prices, a change in environmental or industry regulations, technology transformation and innovation, digital influence on consumer preferences, and even a once-in-a-lifetime pandemic can seal a company's fate or unlock potential for another, irrespective of what leaders do.

Objectives and the sample framework

The purpose of this research was to establish and understand if such a relationship existed in the Indian context. Not many empirical studies deliberate the influence of leadership on organisational performance. In pursuit to trace the relationship, we specifically tracked companies that underwent changes in leadership and analysed their financial performances within a specified interval of the leadership change. This is because, if what is believed is true and leadership does influence company outcomes for reasons quoted in literature, the impact of a leadership change should reflect in that company's performance.

In addition to analysing the relationship between leadership and firm performance, we also tried to understand the profile of better performers and justified the observed performances with business strategies they pursued.

The definition of leadership change was restricted to changes in Chief Executive Officer (CEO)—the highest-ranking executive of an organisation. In addition to managing day-to-day operations, driving high-level corporate decisions, and maximising the business value, the CEO also acts as the organisation's public face.

The empirical setting for the current study was the Indian corporations that have managed to be at the top of performance charts for over a decade. We considered analysing companies that comprised the National Stock Exchange's (NSE) Nifty 50 Index, as of June 2021and were listed with the NSE between January 2005 and February 2020.

The period after FY 2020-21 was not considered for the study because, we believe, the impact of the pandemic-related disruptions on any parameter of company performance was far too overwhelming and cannot be attributed to either industry or organisation-specific factors.

Our selection of the Nifty 50 companies was guided by several considerations. First, we considered only those companies that remained listed at the NSE for the entire one-and-a-half-decade. Second, within that segment, we selected only those companies that experienced at least one CEO change with a new CEO having a run for not less than two

years. Therefore, CEO changes beyond February 2018 were not considered as we excluded the pandemic year from our analysis. Finally, we excluded state-owned companies. Their CEOs have public service priorities because of which, shareholder wealth maximisation is not the only driver for such government-owned companies.

Of the Nifty 50 companies, 25 companies met the above specifications. During the period between January 2005 and February 2020, these 25 companies witnessed 58 CEO transitions. However, tenure for nine CEOs was less than 24 months. Therefore, we considered 49 new CEOs for our study as shown in the matrix below (Figure 1). **Unfortunately, of the 49 CEOs transitioned in the past 15 years, only 3 were women, suggesting a highly skewed gender representation in the top-most executive roles.**

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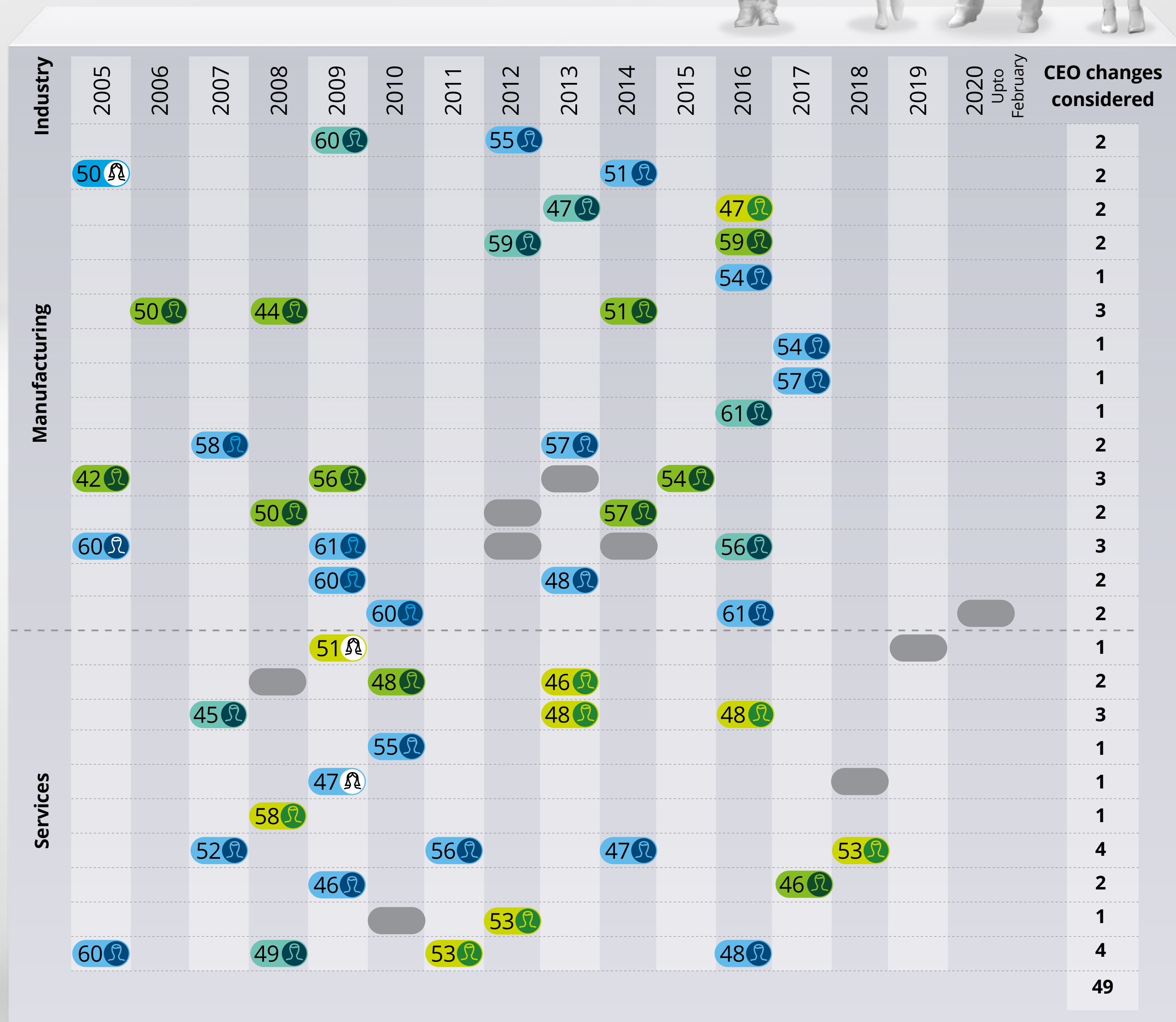
Figure 1. The CEO transition matrix

Of the 58 CEO transitions that occurred during 2005-2020, 49 changes qualified for our analysis

- Promoter stepped down
- Transferred/Promoted
- Resignation/Removed
- Retired/Contract expired
- Excluded CEO changes



Note: The colour of the cell suggests the reasons why the previous CEO stepped down, leading to the appointment of new CEO. The number in the cells indicates the age of the newly appointed CEOs at the time of the appointment. CEOs appointed after February 2018, those who had a tenure of less than two years, or interim or proxy CEOs were not considered for the detailed analysis and are represented in grey.

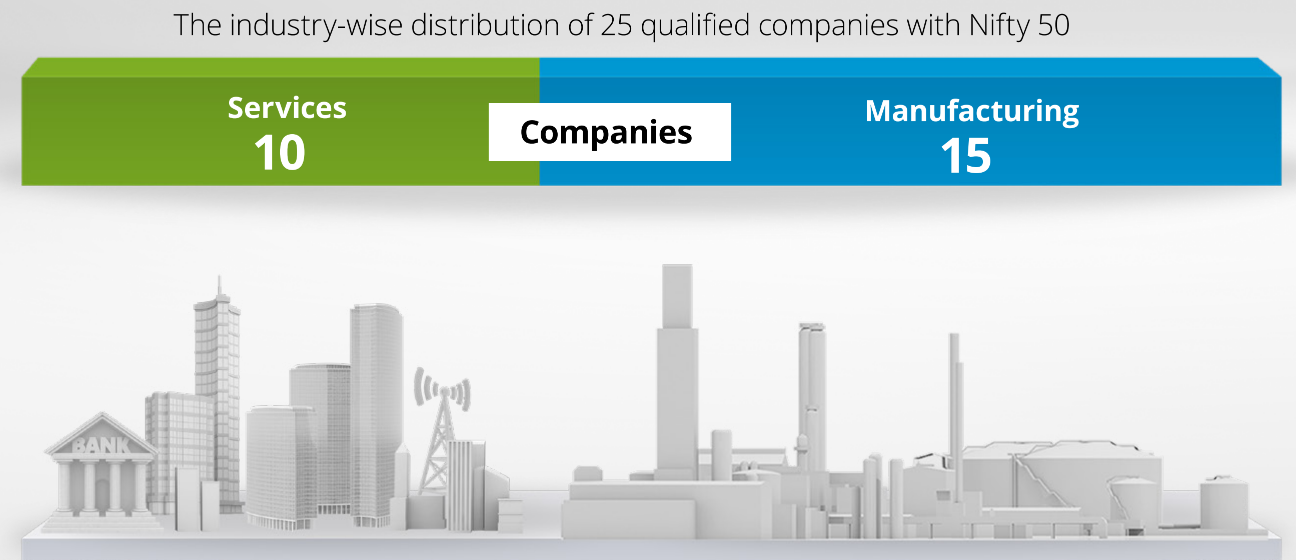
Source: Deloitte Research

Section II. Sample inferences

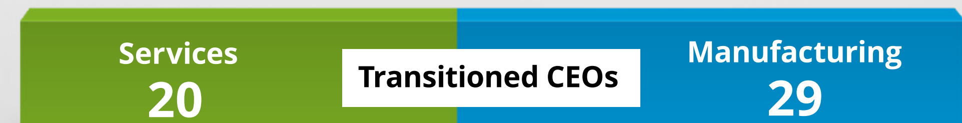
The sample breakdown by industry and the distribution of 49 CEO transitions are depicted in Figure 2. Although manufacturing companies dominate our sample of 25 companies (60 percent) , **the average number of CEO changes per company did not vary between manufacturing and services** during the study period.

Figure 2. Manufacturing companies dominated our sample

The industry-wise distribution of 25 qualified companies with Nifty 50



The industry-wise distribution of 49 CEO transitions tracked between Jan-2005 and Feb-2018



Note: The manufacturing industry includes fast moving consumer goods, chemical and pharmaceutical, automobile, metals, cement, and capital goods companies, while the services industry includes financial services, IT, and telecom companies.

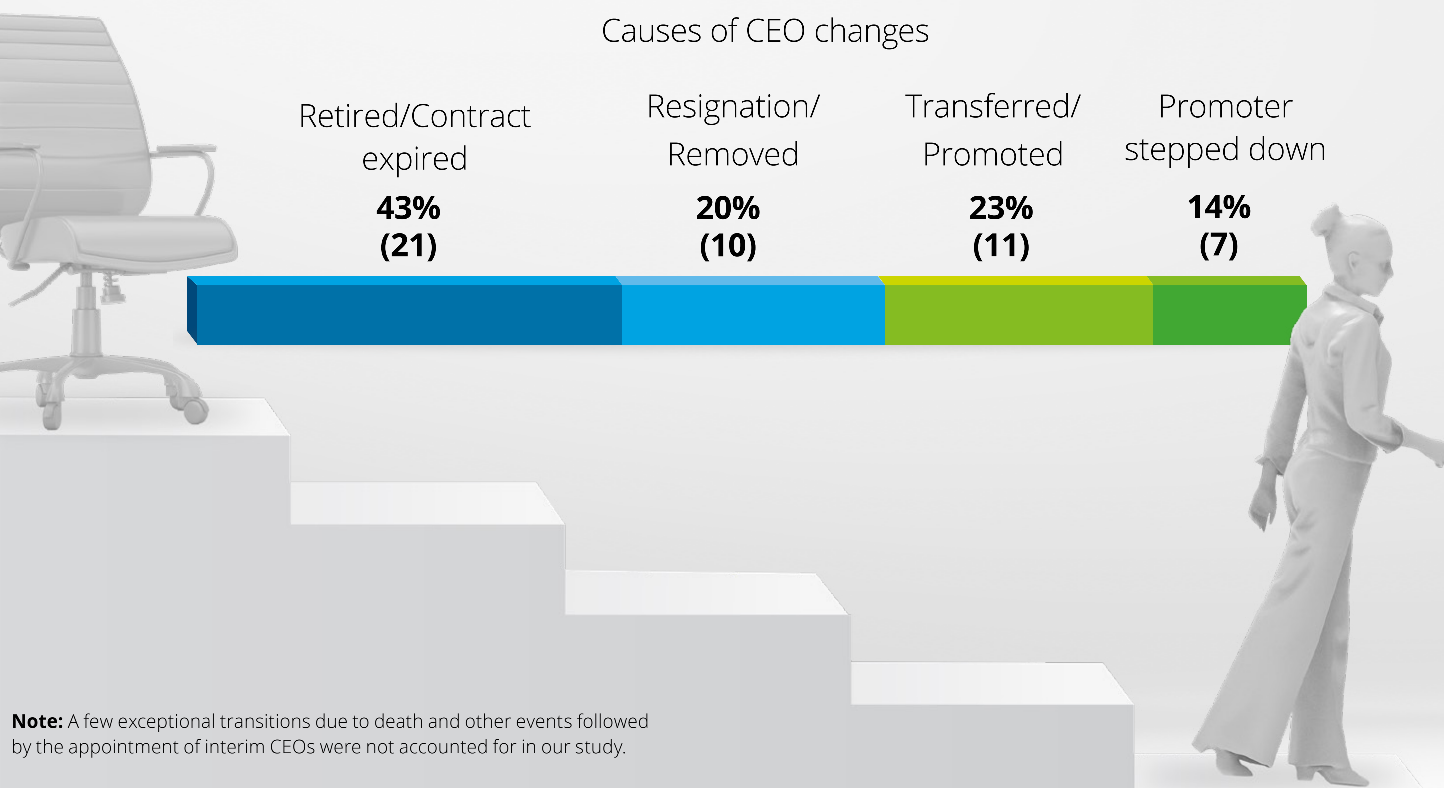
Source: Deloitte Research

A majority of the CEO transitions were on account of retirement or expiry of the contract (43 percent of the total changes in our sample, Figure 3). Contract expiration before retirement was mostly observed in a few IT companies. The next big reason for CEO transition was due to transfers or promotions of the previous CEO (23 percent). About 14 percent of changes were prompted as companies' promoters decided to step down, turning the helm to a successor. In other words, **80 percent of CEO transitions during the study period were gradual with possibly a planned succession by companies to prepare for the change.** It may be prudent to disclaim that a few transfers or promotions may have been unexpected. Yet, we consider them as planned due to lack of information.

Only 20 percent of CEO changes were because of resignations or removal—transitions that were probably neither foreseen nor planned. Although a few companies took some time to decide on successions, there was a period when companies witnessed abrupt changes in CEOs. For our study, resignation and removal were clubbed together as differentiating the two from publicly available information was difficult.

There was a higher concentration of resignations/removals in the services industry (9/10) in comparison with the manufacturing industry. On the other hand, a majority of the transfers and promotions were within the manufacturing industry (9/11).

Figure 3. CEO transitions happened for four primary reasons

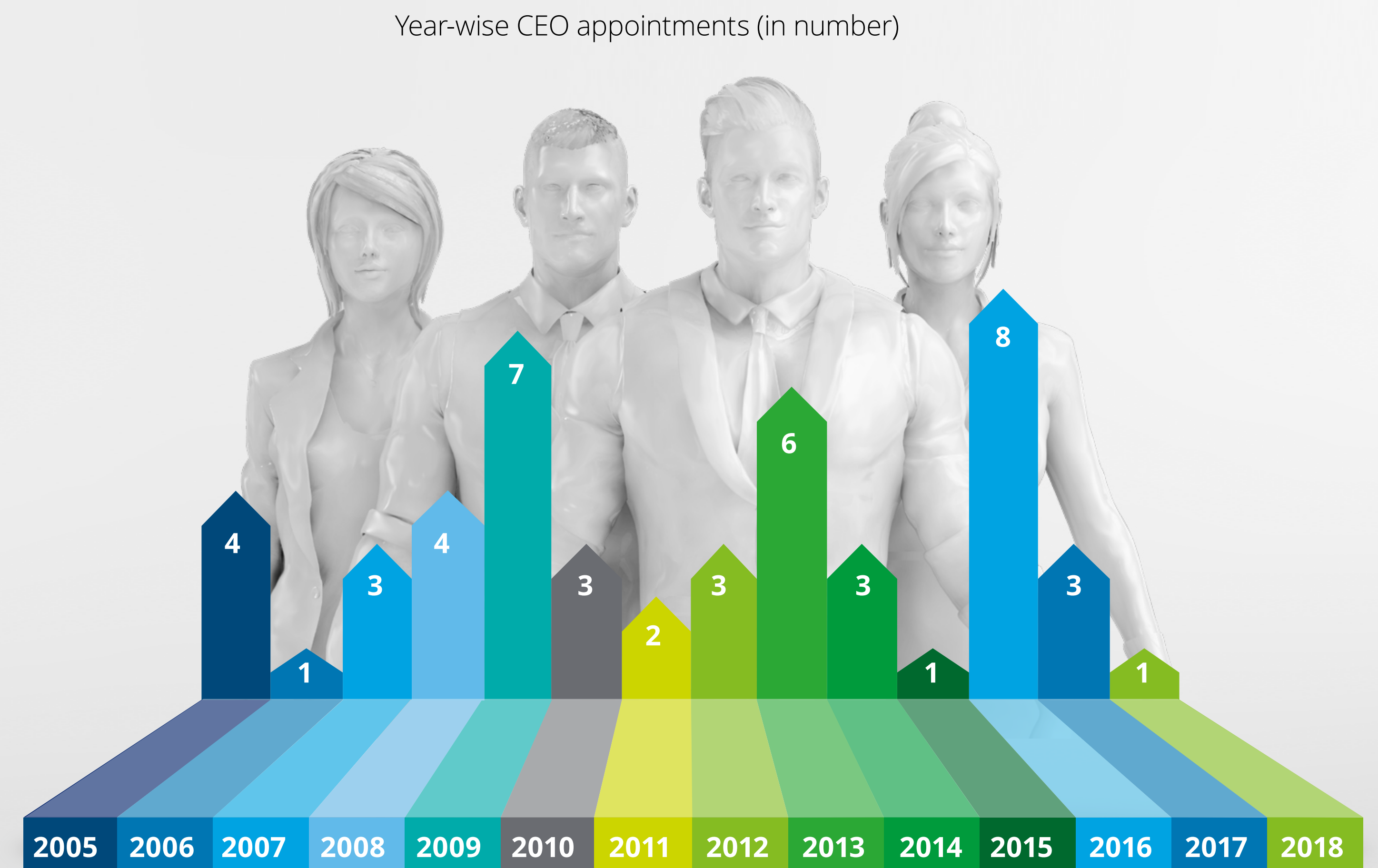


Note: A few exceptional transitions due to death and other events followed by the appointment of interim CEOs were not accounted for in our study.

Source: Deloitte Research

There has hardly been a year during our study period when one or more companies (chosen for the analysis) did not see a CEO transition (Figure 4). However, **a breakdown by year shows the number of churning amongst CEOs was extraordinarily high in years that were associated with difficult and defining years, globally.** Three such years during our study period were – the global financial crisis in 2008-09; the US Fed's taper tantrums that led to a financial turmoil in emerging markets in 2013; and the rising populist sentiments globally after US elections and Brexit in 2016 (redefining world trade and investment relations). Nearly 50 percent of the total CEO changes we studied, and 60 percent of the total resignations or removals happened around these events. However, this is only a preliminary observation and not a confirmation that these events may have had any impact on CEO-related decisions. The precise impact of the macroeconomic environment on leadership changes is something that needs to be explored further and was beyond the scope of this study.

Figure 4. Year-wise distribution shows a sudden increase in CEO appointments in a few specific years



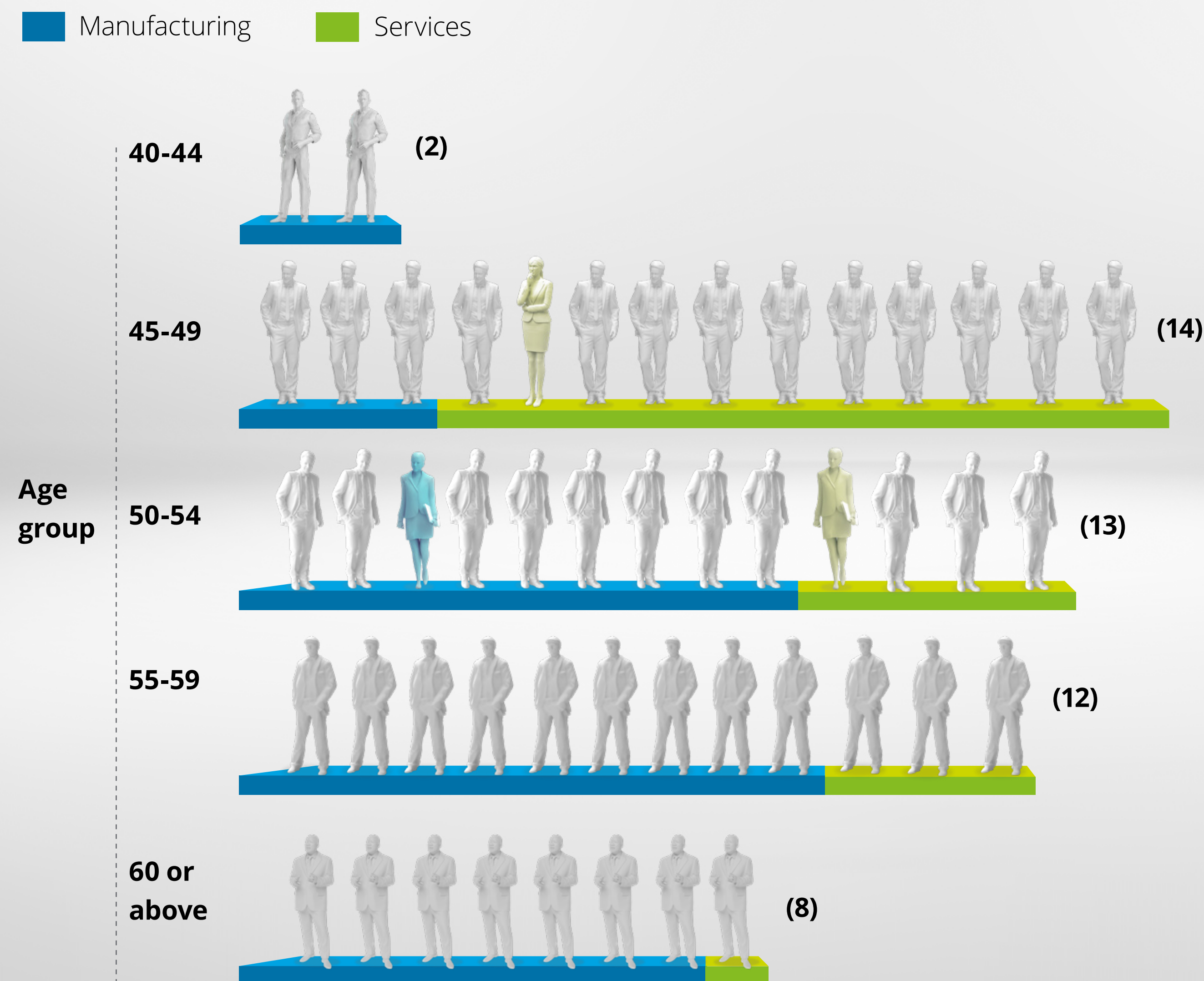
Note: The year 2018 has data until February as we did not account for any changes after this period for our study

Source: Deloitte Research

The age profiles of the CEOs at the time of the appointment suggest a strong preference for experienced executives as the age distribution chart skewed towards the higher age brackets on the age axis in Figure 5. A majority of the appointments happen between the ages of 50 and 59. That said, the median age of appointment between the services and the manufacturing industry differed considerably. **Services companies hired relatively younger CEOs than manufacturing companies over the past one-and-a-half decades.** The median age for the newly appointed CEOs in the manufacturing industry was 56 years while that of the services industry was 49 years.

However, there were two appointments at the age of 40-44 and both of these CEOs were from the FMCG sector.

Figure 5. CEO demographics indicated a strong preference for experienced executives and skewed gender representation



Note: The numbers in the bracket refer to the count of transitioned CEOs

Source: Deloitte Research

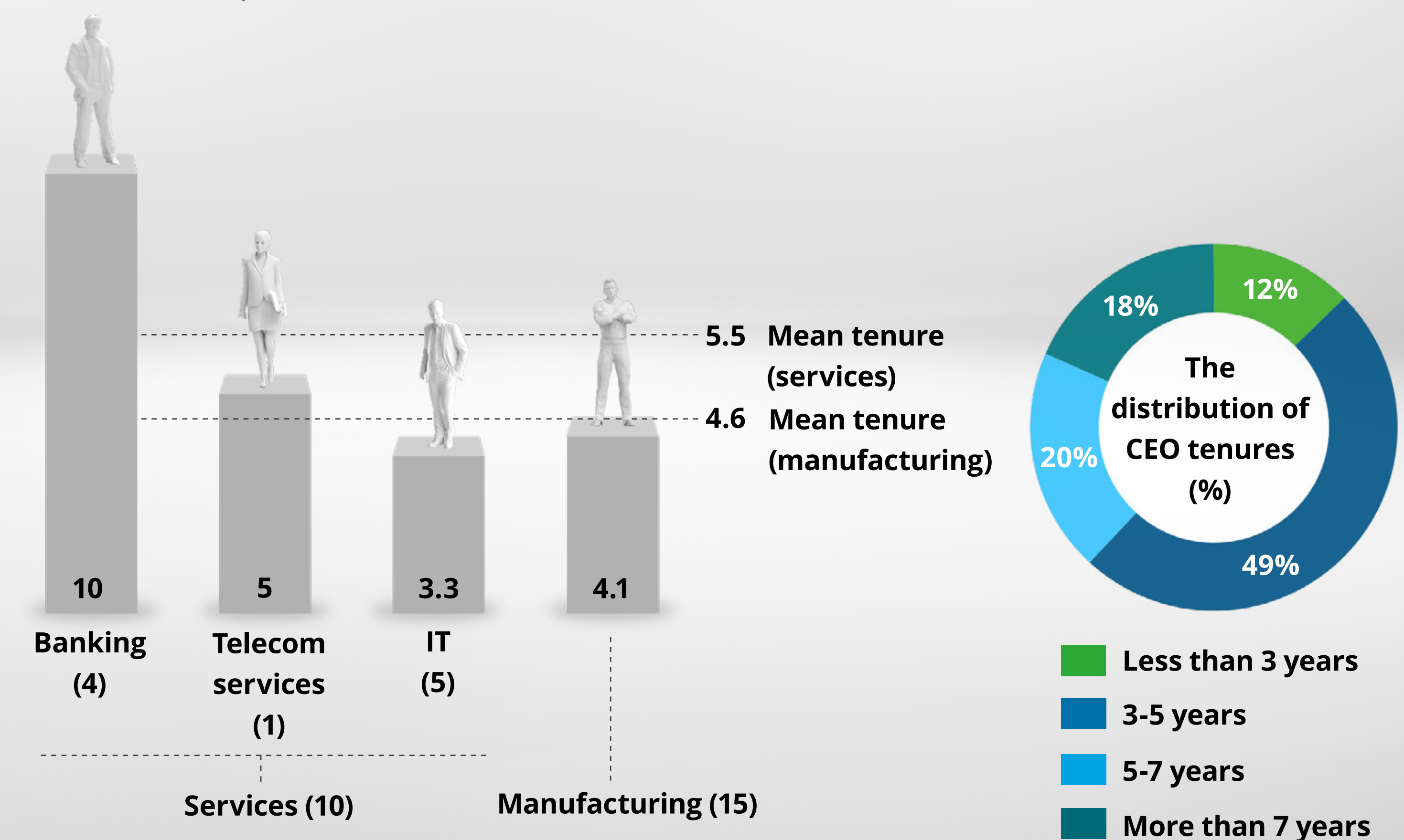
What sets outperforming CEOs apart and how boards can help

A majority of the CEOs (49 percent) that we considered for the study had a tenure of 3-5 years after their appointment (Figure 6). Nearly 18 percent CEOs had a tenure of more than 7 years; 80 percent of which were in the services industry. Even as the median tenure between the group of industries (manufacturing and services) was similar, a closer scrutiny of the sample provided interesting perspectives. The appointed CEOs in the banking services sector had a much higher median tenure (of 10 years) than the manufacturing (4.1 years) and IT services (3.3 years) sectors. Five IT companies, which accounted for 70 percent of the CEO changes in our sample, pulled down the median tenure for services. When we considered the mean instead of the median, the average tenure in the services industry was almost a year more (5.5 years) than that in the manufacturing industry (4.6 years).

In other words, CEOs in the services industry, especially in the banking sector, served their companies longer. As a majority of the CEOs were older at the time of appointment in the manufacturing industry, their average tenure was lower than the CEOs in the services industry.

Figure 6. The tenure of CEOs varied across industries and sectors

Median tenure in years



Note: The median tenure for the two industries was the same but the tenure differed. The numbers in the bracket refer to the number of companies in industries/ sectors. Tenures of CEOs are considered only up to Feb-20 to control for the impact of the pandemic on company share prices

Source: Deloitte Research

What sets outperforming CEOs apart and how boards can help

Section III. CEOs and performance analysis

Our core objective was to establish if a CEO's appointment had a consequential impact on the company's financial performances (either improvement or deterioration). This required us to determine performance metrics, benchmarks, and finally, a score that decided the performance spectrum.

The theoretical framework

Determining the metrics and benchmarks

We used the company's per-unit share value (adjusted for dividends and splits) to measure its performance. The market-determined value of the company provided us a comprehensive representation of investors' perception of risks associated with the organisation and the potential to provide returns in the future. Besides, using share price metrics helped us control the influence of external factors and estimate the premium the company earned over and above the respective industry. The methodology is explained in Sidebar 1.

Sidebar 1: Defining the parameter for measuring performance

We used the company's per-unit share value (adjusted for dividends and splits) as the metric for measuring the company's financial performance. Using share price metrics helped us estimate a relative performance vis-a-vis the respective industry. The industry index provided us a proxy for the external drivers influencing the company's performance metrics. Netting out the industry index from that of the company gave us an approximate estimate of the company-specific drivers determining the premium earned by the company. As this study focuses on leadership and its influence, we attributed the premium to the role of leadership —in our case, the CEO.

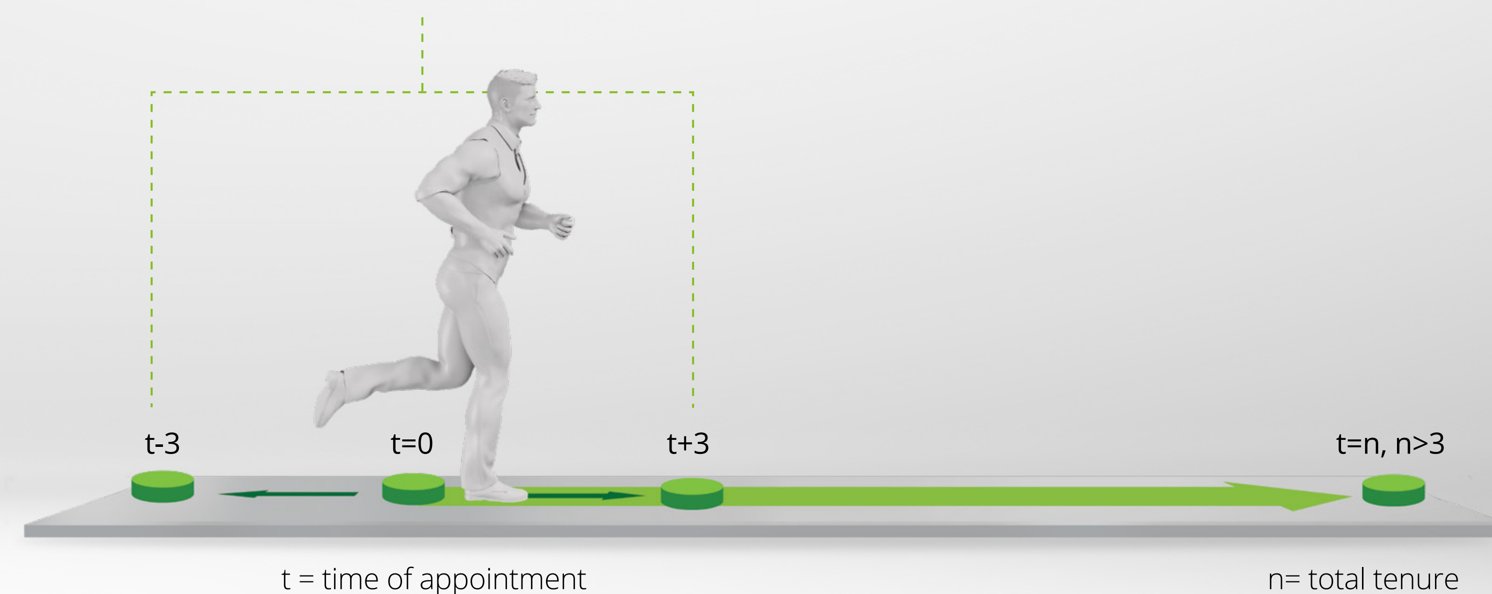
For standardisation, we obtained market-determined share prices for the company from the National Stock Exchange (NSE) and compared them with the respective industry price index (to which the company belonged) provided by the same stock exchange. For instance, a bank's share price obtained from the NSE was compared with the NSE banking index. However, we had to make exceptions in a few cases.

- In the absence of a telecom index on the NSE, we had to use the BSE Telecom index as the industry index.
- For years when the NSE index was not available or price indices were missing, we used BSE index values as substitutes.
- In the absence of an industry index (from both the NSE and the BSE), we used the Nifty 50 Index as the benchmark index.

We focused on a time-bound performance of CEOs after their appointment. This is because, we believe, the novelty of new CEO strategies and their direct influence on companies' outcomes diminishes over time. Moreover, investors' tolerance to gauge a new CEO's performance is often measurable and time-bound. Analysing the performance during the CEO's entire tenure was, therefore, not justifiable. Additionally, a time-bound analysis aided in a comparative analysis of CEOs' performance, and therefore, controlled the bias of CEOs' full tenure on organisational performance.

For our analysis, we compared three years of relative company share price performance before and after the CEO change. Our rationale to go with three years (and two years in a few exceptional cases) is explained in Sidebar 2. The Goldilocks years were neither too short nor too long and enabled us to capture the maximum number of CEO transitions observed during our study period (January 2005 to February 2020).

Figure 7. Explanation to measuring the timelines for performance



Source: Deloitte Research

Sidebar 2: The rationale for using three years for performance assessment
There were several justifications for the choice of years to be three. Our sample analysis earlier suggested the median tenure to be 4.1 years. In addition, one of our findings (explained later) indicated that a majority of the CEOs reached the peak of their performances between 2 years and 3 years. In other words, the choice of three years appeared to be the Goldilocks years as they are neither too short for CEOs to prove their ability, nor too long for boards, shareholders, and investors to wait for a perceivable change in valuations.

For a few cases, we noticed two consecutive CEO transitions happening after two years of appointment, but before the completion of three years of the first CEO. In such cases, we measured the relative company performance for the entire tenure of two or more years and compared it with the relative performance of similar number of years before the change.

Constructing performance scores

For every CEO, we used four different methods to capture the movement of the company's per unit share value (adjusted for dividends and splits) relative to that of the respective industry price index (to which the company belongs) in the first three years after the appointment. We then constructed a composite score using these four different methods for each CEO. The methodology is discussed in Sidebar 3.

Based on composite scores, we classified CEOs into four groups based on their performance—stalwart, high performer, modest performer, and laggard.

Sidebar 3: Methodology for constructing scores
We assessed a CEO's performance by comparing the movements in the company's share prices relative to the respective industry index. We used two methods to capture the relative performances:
• Growth (CAGR) of the company share prices vis-a-vis the industry price index
• The ratio of the company share prices to the industry price index

We then analysed four questions to capture the relative movements and assigned a binary score of 1 or 0, per our criteria for three responses. For one response, we assigned scores between 0 and 1:

1. After the CEO's appointment, was the company's share price CAGR higher than the CAGR of the industry price index at the end of the third year?

   The criterion for scores: 1 if Yes, 0 if No

2. We defined the difference in the CAGR of company share price and the CAGR of the industry price index as the premium. Did the newly-appointed CEO enhance the premium after the first three years of the appointment relative to three years before the appointment?
   The criterion for scores: 1 if yes, 0 if no

3. Alternatively, we measured the premium as the ratio of the company share price to the industry price index and tracked that ratio until the end of the third year after the CEO's appointment. We then created ranges based on the distribution of the ratio and assigned scores to each of the ranges. Did the newly appointed CEO increase the premium after the first three years of the appointment relative to three years before the appointment?
   The criteria for scores were:
   1, if the ratio > = 1.4
   0.5, if the 1.1< ratio < 1.4
   0, if the ratio < = 1.1

4. Did the company share price to industry price index ratio increase consistently in the first three years of the appointment?
   The criterion for scores: 1 if yes, 0 if no

The composite score of a CEO was then obtained by aggregating scores and giving each of them equal weights. Based on the scores, each CEO was classified into stalwart, high performer, modest performer, and laggard; with 'stalwart' being assigned the highest score of 4 and 'laggard' receiving the lowest score of 0. CEOs receiving total scores between 1 and 2.5 were categorised as 'modest performers', while those with 3 or 3.5 scores were categorised as 'high performers'. For a few borderline cases, scores failed to reflect actual performance. We were required to intervene in classifying such CEOs.

Note: During this study, we have referred to 'stalwarts' and 'high performers' together as outperformers for ease of reference.

Movements in company's share value across four different methods are referred to as 'company performance' in the rest of the document.

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Limitations of the study

Our research had certain limitations. First, the selected companies had a survivorship bias as they have been listed on the NSE for more than 15 years, including our period of study. This tilts our sample towards CEOs who managed the best of the lot. Second, although we tried to control for external influences while calculating performance metrics, several company-specific characteristics determine the performance path and could not be separated from the influence of the leadership.

Despite these limitations, the study provides useful insights about common characteristics of different CEOs and their performances that could be factored in by boards while appointing CEOs. It also provides strategic measures that new leaders, in our case CEOs, may aspire to follow to make a differential impact. The findings could be the basis for new learning and then be pursued to build successful organisations.

Results and insights

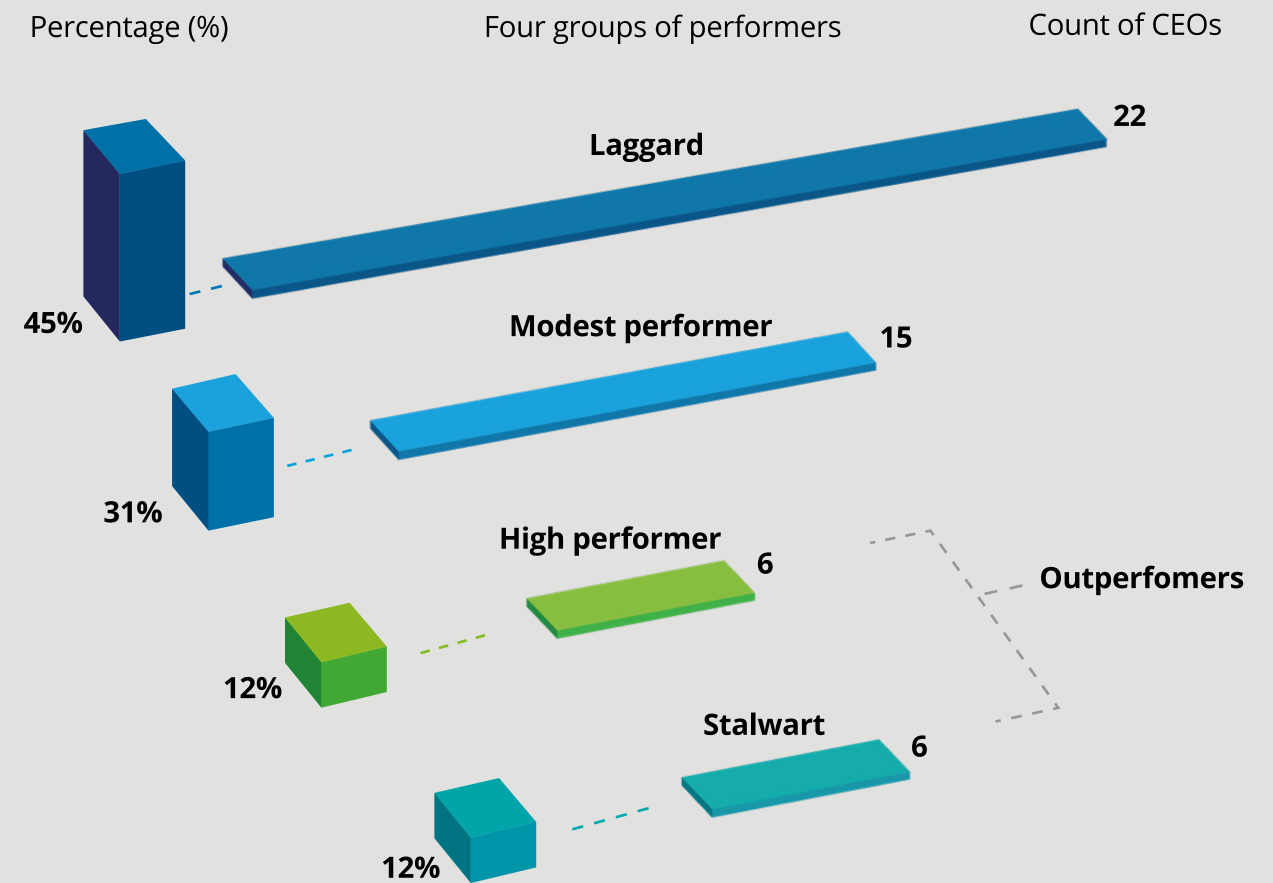
Our analysis threw several interesting insights. In addition to the relationship between CEO and company performances that we wanted to establish, we also drew insights into how performers made a difference to the company premium and how they were rewarded by their investors.

CEO appointment and company performance

Our analysis suggests that of the 49 CEO transitions that we analysed between 2005 and 2020 amongst the 25 Nifty 50 companies, nearly 55 percent improved the company performances within the first three years of their appointment compared with the previous three years before their appointment. Of these better performers, 24 percent were outperformers, while 31 percent performed modestly (Figure 8).

Therefore, for a majority of our sample companies, newly appointed CEOs helped improve their companies' performance.

Figure 8. Nearly 55% of the CEOs improved company performance within the first three years of appointment



Note: Based on the composite scores as described in the methodology, the CEOs under study were classified into four groups of performance.. Stalwarts and high performers are referred to as outperformers in the study.

Source: Deloitte Research

What sets outperforming CEOs apart and how boards can help

Taking one step further, we wanted to know if better-performing CEOs (including stalwarts, high performers, and modest performers) could significantly improve their company's financial performances after the appointment. Of the various methods considered for measuring performance (mentioned in Sidebar 3), we chose to compare the premium the company earned on its share price (over and above the respective industry price index) before and after the appointment. The idea was to understand if the new CEO made an impact on the premium earned by the company and if that impact was significant.

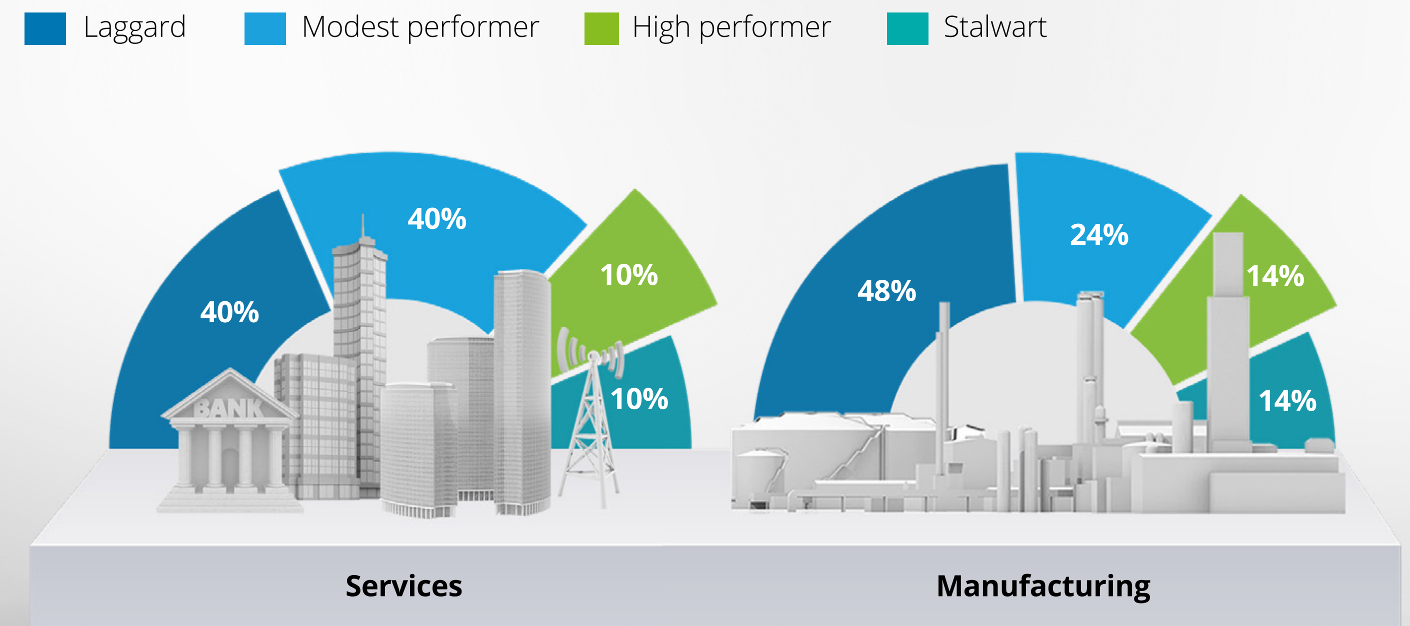
When we considered the better-performing CEOs as our set (55 percent of the CEO changes), the average premium went up from -0.67 percent in the three years before the appointment to 11.84 percent after the three years of the appointment. This increase was highly significant at the 99 percent level of confidence. In addition, when we considered just the outperformers (24 percent of the sample), the average premium went up from 0.64 percent to 22.3 percent before and after the three years of appointments; the increase was also significant at the 99 percent level of confidence. This confirms our proposition that a better-performing CEO can significantly improve the company's performance.

A few other interesting observations are highlighted below:

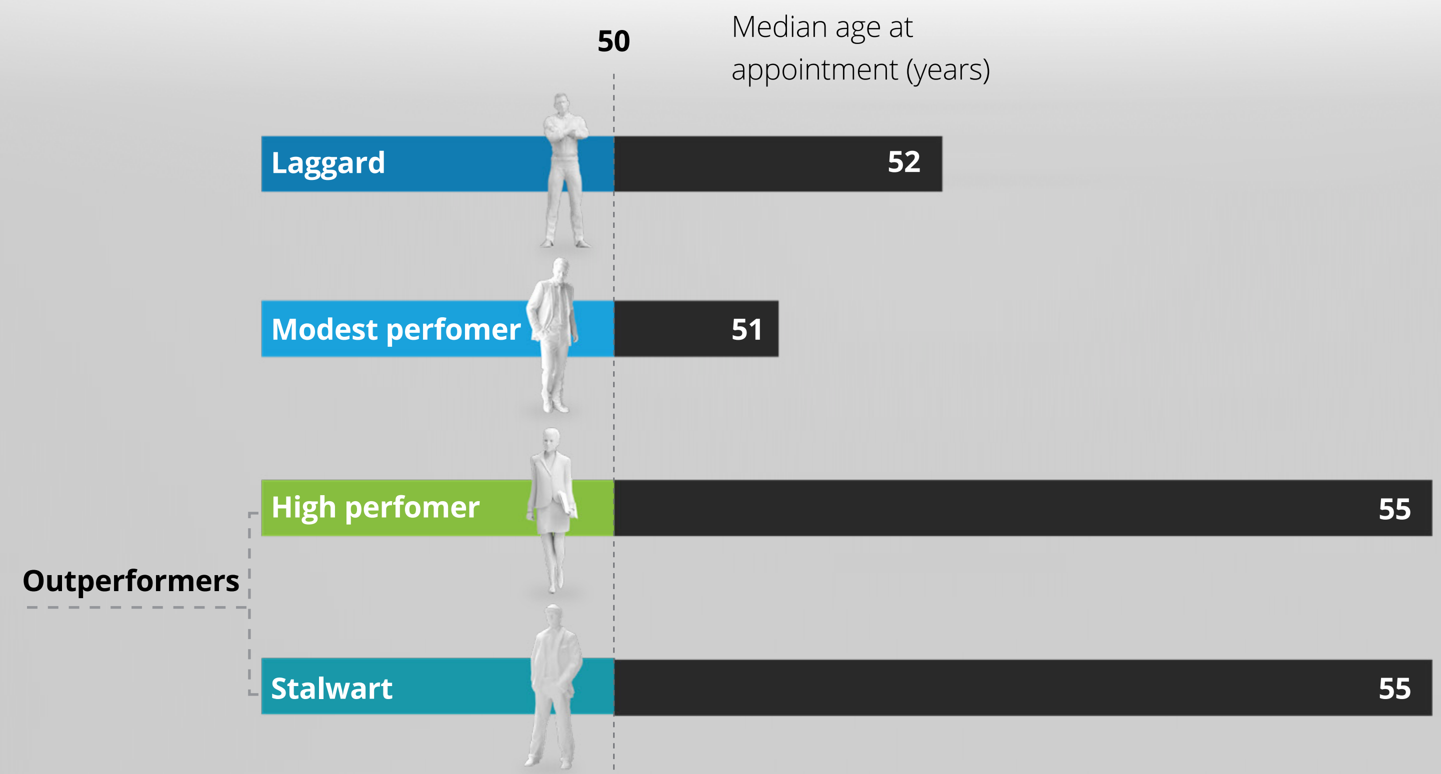
- **About 7 CEOs reversed the growth in share prices from negative to positive within the three years of their appointment compared with the previous three years.**
- **Nearly 11 CEOs reversed the company premium earned on its share prices (over and above the industry index) and improved it within the first three years of their appointment.** These companies were underperforming their respective industry indices earlier and the new CEO accelerated growth to beat the respective industry indices after their appointment.
- **The appointed CEOs in the services industry performed marginally better than manufacturing industry CEOs** (Figure 9). However, the manufacturing industry had a higher share of outperforming CEOs (28 percent) than the services industry (20 percent).
- **The outperformers were found to be significantly older than the rest** (Figure 9). The median age of outperformers was considerably higher at the time of appointment in comparison with 'laggard' and 'modest performing' CEOs.

Figure 9. A majority of outperforming CEOs were relatively older and belonged to manufacturing companies.

The industry-wise distribution of CEO groups



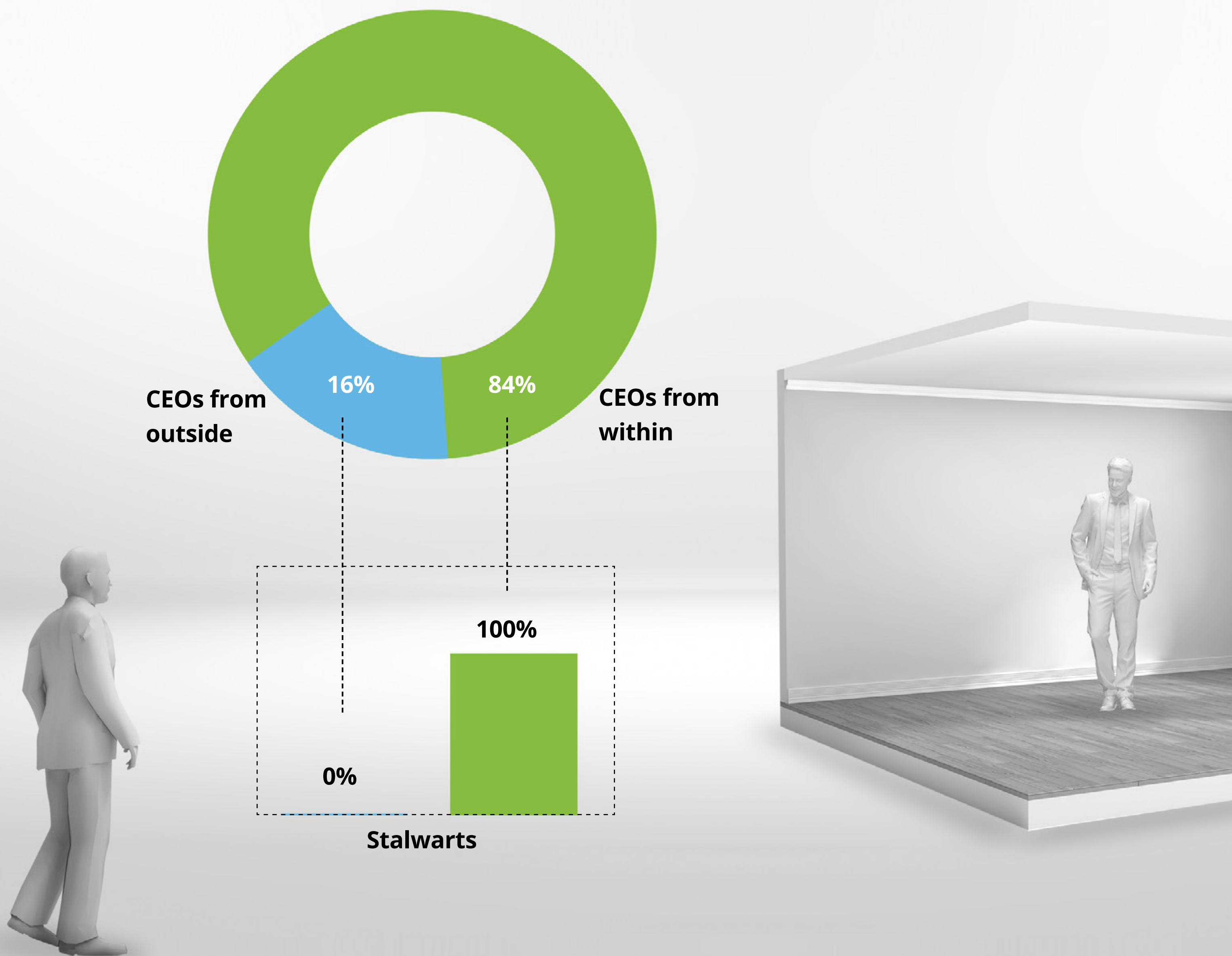
Age-wise distribution of four CEO groups



Source: Deloitte Research

- **About 80 percent of the newly appointed CEOs who transitioned because of resignation or removal of the outgoing CEO turned out to be either laggards or modest performers after three years of their appointment.** This strengthens the argument that companies do not cope well with unforeseen and unplanned CEO changes. Besides, investors do not perceive sudden leadership changes favourably.
- **A majority of the appointed CEOs were from within the organisation** and only one of every six appointments were from outside. There was a clear preference to hire a CEO from within. This could be because such leadership changes are often gradual and well-received as investors are assured about the incoming CEOs' familiarity with the industry and the company. A distinct observation was that all the 6 stalwarts in our sample of 49 CEOs were internal appointments (Figure 10).

Figure 10. All stalwarts were appointed from within the organisation



Source: Deloitte Research

CEO stability and company's equity premium

A few companies witnessed frequent CEO transitions during the study period. We wanted to understand if frequent transitions had any impact on company's equity premium. In our sample, nine companies experienced three or more CEO changes between January 2005 and February 2018, while the rest of the 16 companies witnessed at most two CEO transitions.

A comparison of L-T premium growth of share prices (over and above the respective industry price index) by the two groups during this entire period provided an interesting yet intuitive insight. The companies with fewer CEO transitions enjoyed more than twice the average premium CAGR of 3 percent as against those with frequent CEO transitions during this entire period.

Therefore, frequent CEO transitions did impact the company's ability to improve premium in the long run. The number of CEO transitions was inversely related to the company premium, suggesting that more changes in CEOs led to lower growth in the company's equity premium. This is intuitive to our expectations of shareholders losing confidence in companies because of frequent changes in CEOs on account of uncertainties.

There was a high concentration of outperformers (75 percent) in companies with less frequent CEO transitions during the study period. This is obvious as these outperforming CEOs enjoyed a longer tenure. Only three of these outperformers (of the 12) were from companies that underwent three or more CEO changes. What we also learned was that companies with at least one outperforming CEO generated significantly higher (statistically) average premium. We had 11 such companies that were led by at least one 'stalwart' or 'high performer' and earned an average premium of 4.9 percent after their appointment, compared with the rest of the sample companies (with neither of the two) that earned an average premium of 0.5 percent. **In other words, a company led by outperformers had higher earnings growth and created greater long-term value for their shareholders.**

CEO performance and tenure

Outperforming CEOs were rewarded with a longer tenure. They served their companies much longer and their median tenure was longer (60 percent) than the laggards. On the other hand, the CEOs who did not prove to be effective within the first three years of their appointment had a shorter tenure (Figure 11). In fact, CEOs with less than a three-year tenure were largely laggards or modest performers.

This makes intuitive sense as better performing CEOs enjoyed the confidence of the shareholders and the board for a longer duration. The same rationale holds for investors who may have preferred the continuity of CEOs and their strategies that improved companies' performance, and provided more certainties in returns.

That said, there appeared to be indifference between modest performers and laggards. This led us to ask if the laggards were performing better in some parameters that we did not consider, thereby, justifying this observation. We found that the possible reason could be in looking at the absolute values of share prices (that we had not considered for this analysis so far), and not just the relative premium the company earned.

Figure 11. Outperformers enjoyed a longer tenure

Median tenure (in years)

Note: Tenures of CEOs are considered only up to Feb-20 to control for the impact of the pandemic on company share prices

Source: Deloitte Research

Time taken to reach the peak performance

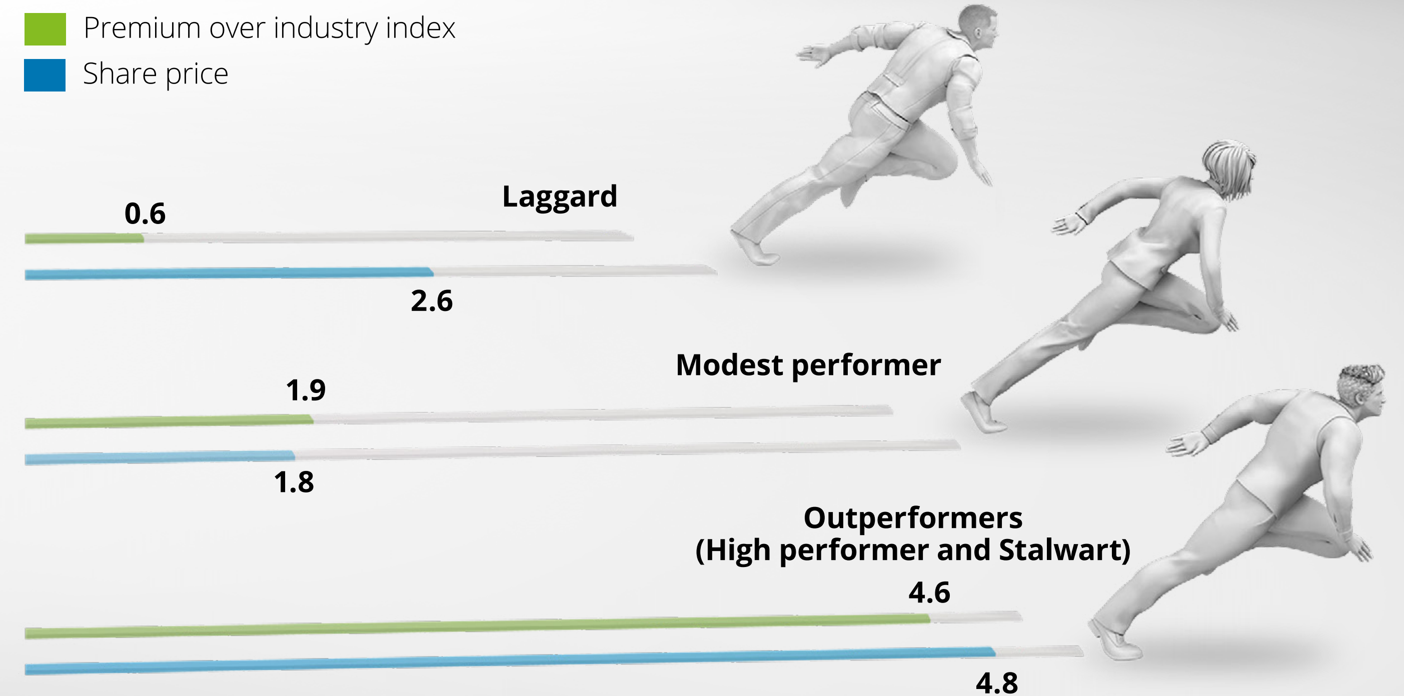
We, therefore, examined the yearly movement in the company premium and the absolute share prices during the entire tenure of a CEO to estimate the time the CEO had taken to reach the peak performance (Figure 12). While the median tenure of the appointed CEOs ranged from 3 years to 5 years (Figure 6), **a majority of them reached their peak performance between 2 years and 3 years; the performance tapered thereafter.**

Performance of a majority of the outperformers crested much closer to the end of their tenure, suggesting that these CEOs consistently outperformed from the start of their tenure until the end. As this set of CEOs also had a longer tenure to their credit, a few of them reached their performance peak well beyond the three years after their appointment. This suggests that their influence on companies' performance lasted much longer than the Goldilocks period that we considered optimal for comparing performances.

As expected, the laggards peaked much earlier in their tenure. However, these laggards did better than modest performers when absolute share prices were compared (Figure 12). This possibly explains why they enjoyed a slightly longer tenure than the latter, as mentioned in the previous section.

Figure 12. Performance of outperformers crested much closer to the end of their tenure

Median time taken to reach peak performance (measured by two metrics, in years)



Note: The performance metric has been measured using two variables: The absolute company share price and the premium over industry index (by estimating the ratio of company share price to the industry price index). We captured the number of years CEOs took to reach the maximum of these two metrics.

Source: Deloitte Research

Section IV. Business strategies and performance

To complement our findings, we focused on CEOs who outperformed (stalwart and high performer) and identified key business strategies they pursued. For this, we referred to the annual reports published in the first three years after their appointment. We also studied key financials of the companies during these first three years of their tenure to understand if strategies had the desired financial impact.

Strategic initiatives by outperformers

The top five key strategies pursued by the outperforming CEOs (stalwarts and high performers) in the first three years of their tenures are mentioned below:

- Building capacity to achieve economies of scale
- Offering new products or services
- Expanding into foreign markets
- Improving supply-chain efficiencies
- Focusing on customers and their experiences

In addition to these, other strategies were optimising cost, improvising products, improving profit margins, robust marketing and branding, and taking digitisation and synergistic diversification (Figure 13).

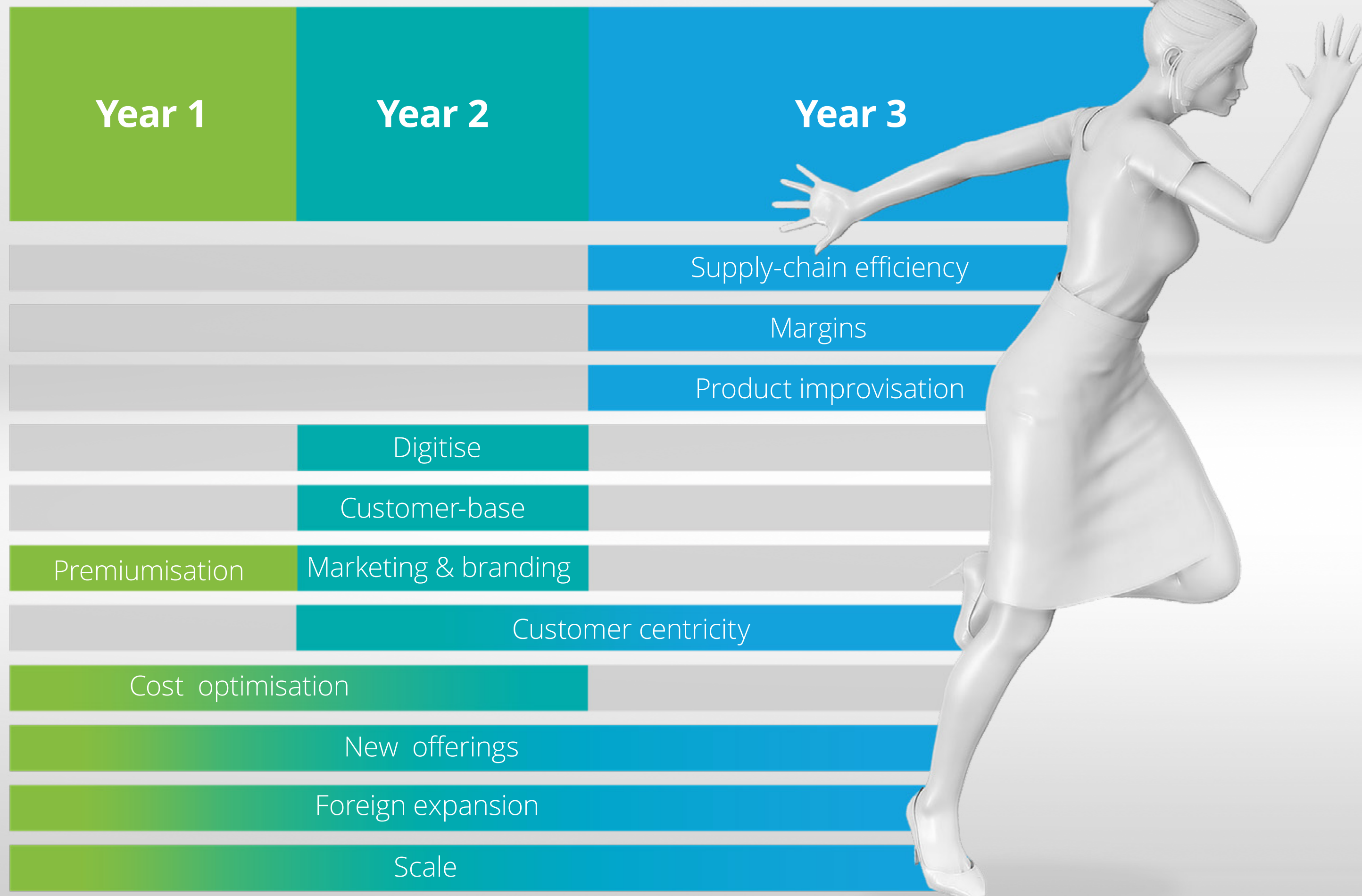
Figure 13. Top key strategies pursued by outperformers

Source: Deloitte Research

We also observed some differentiating patterns in CEO strategies in each of the first three years (Figure 14). Initially, the primary focus was on new offerings and building capacity to achieve economies of scale. Once the new CEOs settled in their new roles, they focused on enriching customer experience, expanding customer base, and increasing global footprints. By the end of the third year, CEOs directed their attention towards improving their company profit margins, expanding into the global market, and adopting supply-chain efficiencies. In addition to focusing on newer strategies every year, they continued with several of their previous successful initiatives.

Interestingly, while a majority of the outperformers continued to build on strategies of their predecessors, there was a visible shift in the focus away from collaborations, M&A, and dealership expansion. Instead, in the first few years, they focused more on operations and efficiencies such as scaling up, offering new products, and optimising costs.

Figure 14. The top business strategies of outperformers had certain commonalities (year-wise analysis)



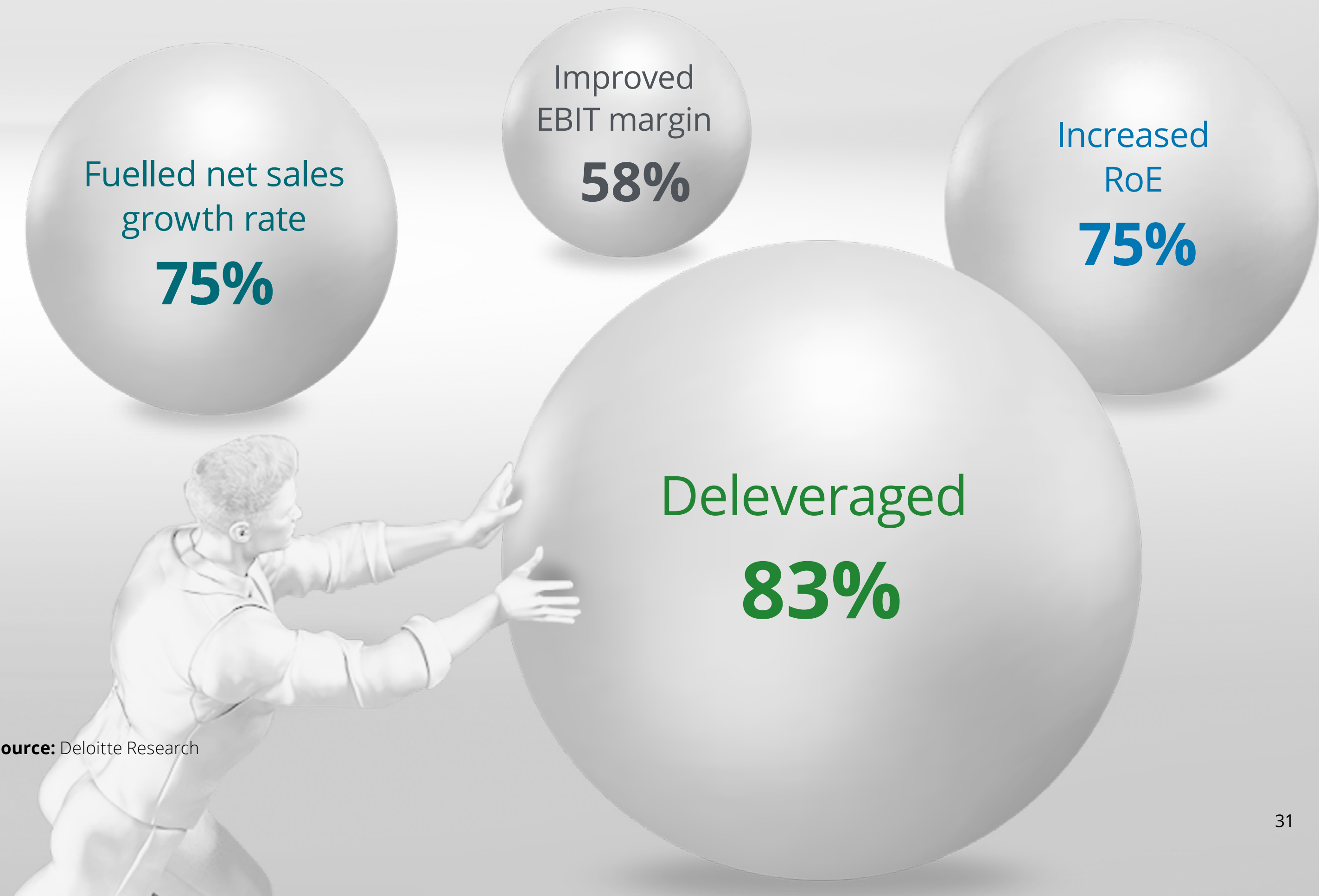
Source: Deloitte Research

What sets outperforming CEOs apart and how boards can help

A deeper dive analysis of the company financial trends within the first three years of the appointment provided additional insights about the strategies pursued by the outperforming CEOs.

- The outcome of these strategies was evident on the top line as 75 percent of these outperforming CEOs improved growth rate in net sales.
- **Growth in net sales adjusted for inflation suggests that these CEOs improved sales, beating inflation.**
- However, the success in improving profit margins (EBIT) was slightly lower despite high net sales growth. That said, nearly 75 percent CEOs improved EBIT margin better than their respective industry.
- For the majority of the CEOs, higher top line and improved profit margins (EBIT) did have an impact on the bottom line; 75 percent outperforming CEOs improved RoE.
- **One common theme we observed was that a majority of these CEOs (83 percent) focused on deleveraging their balance sheets.** This could be because these CEOs were appointed during and after the global financial crisis in 2008-09. Companies may have had higher leverage due to high liquidity that preceded the crisis and maintaining healthy balance sheets was imperative.
- We had two financial companies on the list of outperformers. Both the CEOs reduced their Non-Performing Assets (NPA) and maintained their net interest margins.

Figure 15. A majority of the outperformers focused on deleveraging



Source: Deloitte Research

Section V. Key findings and recommendations

The questions that have intrigued everyone in business research are, **how much influence does a CEO have on a company's performance and what role can the board play in enabling a newly appointed CEO to make that desired impact?**

To answer the above question, we conducted a detailed study of a select few NIFTY 50 companies that witnessed CEO transitions over the past 1.5 decades since 2005; some valuable insights emerged. CEO demographics suggested a strong preference for experienced executives and skewed gender representation. We found sufficient evidence that CEOs had a significant impact on Indian companies' performance (we sampled), with successful ones outperforming their peers by a margin. We also learned about the mix of strategies pursued by outperforming CEOs that led to exceptional organisational performance. The research also provided insights into what company boards can do in transitioning new CEOs, establishing performance measures, and helping them succeed in their role. Based on our findings, we shared a few key insights for CEOs and boards that may help them in improving their companies' performance.

What made great CEOs?

- **Methodically developed diversified strategies:** We focused on strategies that the outperforming CEOs pursued in the first three years of their appointment; a few commonalities emerged. Amongst the key strategies, the initial emphasis was on new offerings and building capacity to achieve economies of scale. After the new CEOs settled in their new roles, they pursued strategies such as enriching customer experience, expanding customer base, and increasing global footprints. By the end of the third year, these outperforming CEOs were working towards improving their companies' profit margins, expanding into the global market, and adopting supply-chain efficiencies. The mix of strategies in the first three years had an equal emphasis on the engine room activity as well as customer satisfaction and scale expansion, amongst others, which led to exceptional company performance.

- **Never took eyes off the ball:** In addition to improving companies' top line and bottom line (including growth in net sales beating inflation) we found that a majority of the outperforming CEOs (83 percent) focused on maintaining the balance sheet's health, apart from improving their profit and loss account. This shows that as these outstanding CEOs pursued different strategies after taking up the baton of leadership, they ensured to impart shareholders the confidence in their ability to sustain the business.

- **Pursued strategies with consistency that worked:** Many outperforming CEOs continued previous initiatives and strategies of their predecessors that worked without re-inventing the wheel. Besides, the outperformers reached their peak performance much closer to the end of their tenure (which was more than three years). This suggests outperforming CEOs' performance consistently improved from the start of their tenure until the end.

How can the board of companies make a difference?

- **Build a strong leadership pipeline:** We found all stalwarts in our sample were appointed internally. This could be because a home-grown insider brings in more consistency and continuity due to better familiarity with the company's operations. Again, age may be just a number. We found that outperformers were relatively older (by an average of 3.5 years) than the modest performers and laggards. Age brings in the experience, which, in our study, may have contributed to the company's success.

- **Ensure a smooth transition:** There was clear evidence that companies did not cope well with unforeseen and unplanned CEO changes. A majority of the appointed CEOs (80 percent) who took over after resignation or removal of the outgoing CEO, turned out to be either laggards or modest performers after three years of their appointment. The study threw light on the fact that boards have a shared responsibility with CEOs to ensure better performance outcomes. Board governance can be an important factor in ensuring a well-planned and smooth transfer of a newly appointed CEO.

- **Set clear performance expectations and give adequate time:** Our study did point to best practices followed by outperformers in the one-to-three-year time horizon that involved strategic continuity, customer focus, and the broader health of the balance sheets, amongst others. Further, we found that the outperforming CEOs reached their peak performance much closer to the end of their tenure (average years to the peak was above 4.5 years). On the other hand, those who peaked in 2-3 years could not sustain performance thereafter. Establishing prudent short-term and long-term goals and deciding on the time horizon may prove to be critical to a company's performance.

- **Avoid frequent changes:** The study showed that frequent changes in CEO reduced the company's potential to improve premium, thereby, hurting shareholders' long-term returns. The companies with fewer CEO transitions enjoyed an additional average premium CAGR of 1.5 percent against companies with frequent CEO transitions during the period. Stability

What sets outperforming CEOs apart and how boards can help

and continuity of CEOs ensured higher returns. That explains why outperformers were rewarded with a longer tenure (at least 60 percent more) than modest performers and laggards.

- **Be prepared for domain-related uncertainties:** A majority of resignations/removals occurred in the services industry compared with the manufacturing industry, suggesting that barriers to entry and economies of scale probably provided higher stability to top executives. This requires the board to be cognizant of sector-related uncertainties and uniqueness while hiring, tracking, and recognising CEO performance and initiating change, if need be, to ensure a sustained long-term performance of the companies. The board should have a plan for situations requiring urgent changes and an established strategy for such appointments, keeping in mind the findings mentioned above.

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