



CEO charisma, compensation, and firm performance

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Abstract

We examined the relationships among CEO perceived charisma, CEO compensation packages, and firm performance in a sample of Fortune 500 companies over a 10-year period. CEO charisma ratings obtained from company CFOs and VPs for HRM were directly related to total CEO pay but not to any firm performance measures. CEO perceived charisma also was related to shareholder value, under highly uncertain conditions. In essence, charismatic CEOs seem able to influence their compensation packages and stock prices but not other indicators of firm performance. Implications for future charismatic leadership research and CEO compensation–firm performance work are discussed.

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Keywords: CEO perceived charisma; Firm performance; CEO compensation packages; Crisis and uncertain conditions

1. Introduction

Conventional wisdom, supported by research, is that CEOs have strong effects on organizations (Reinganum, 1985; Smith & White, 1987; Thomas, 1988). Recognizing this point, many researchers

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and practitioners have agreed with Bennis and O'Toole's (2000) call for boards of directors to choose more effective CEOs by focusing on leaders with more than just standard managerial competencies and who demonstrate "integrity, provide meaning, generate trust, and communicate values" (p. 171). The basis for this argument, calling to mind examples such as Intel's Andy Grove, Corning's Roger Ackerman, and TIAA-CREF's John Biggs, is that some very effective CEOs appear to have characteristics associated with charismatic leaders, and that such leadership results in superior firm performance.

That the success of these CEOs can be attributed to their charisma, however, is based upon nonsystematic observations by the popular press and some academics. However, others who have looked at this same issue in more systematic ways are not in complete agreement with this conclusion because the little existing empirical evidence raises questions about the generalizability of "charisma" as a critical attribute for CEO success. For example, Collins (2001) examined companies that had substantially outperformed the market and their industry over 15 years and concluded that the best chief executives are not terribly charismatic, but rather nurture talent in their companies. The situation is further exacerbated by how charismatic CEOs are compensated. The results of a study by Khurana (2002) concluded that when hiring "charismatic" CEOs, boards of directors granted them extremely large compensation packages that included high salaries, bonus opportunities, and stock options, that have been termed "outrageous" by some critics (Krugman, 2002).

In this study, we examine these issues, framing them in terms of the following two questions: Do organizations led by charismatic CEOs outperform those headed by less charismatic CEOs? What is the compensation of charismatic CEOs, relative to other, less charismatic CEOs?

2. CEO charisma and firm performance

Charisma is based on the feeling of oneness that a person has with another, the desire for that feeling, or the personal attraction to be like the other: the stronger the attraction, the stronger the power (Bass, 1990; Fiol, Harris, & House, 1999). Those who are attracted to the charismatic leader trust the leader's beliefs, are emotionally involved with the leader, and believe in the leader's ability to accomplish the mission (Weber, 1947). Two recent theoretical perspectives have been proposed to explain the link between CEO charisma and firm performance. One, by Cannella and Monroe (1997), focused on how charismatic CEOs develop relationships to ensure the effective implementation of strategic decisions. They proposed that charisma and inspirational leadership are relevant because of their association with the *implementation* of the strategic decisions, and not so much because of their relationship to the *choice* of strategies.

The other, by Waldman and Yammarino (1999), focused on the processes by which these relationships develop and, more importantly, on how they are linked to firm performance. They say that CEO charisma works through both "close" and "distant" relationships. The CEO's charismatic behaviors increase team cohesion within the top management team, with whom the CEO is closely and directly involved, when the environment is uncertain. This cohesion then results in increased role modeling of charismatic behaviors at lower levels of management, heightening intragroup and intergroup cohesion and effort at lower levels. CEO symbolic behaviors, vision, and story telling also increase cohesion and effort at lower levels when there is perceived environmental uncertainty. The increased cohesion and

effort from both the close and distant relationships lead to more coordinated performance of organizational units, resulting in higher organizational performance.

The main body of substantive research on charisma has not focused on CEOs and firm performance, but on the relationships of charisma and different criteria in other settings. For example, studies have found an association between charisma and performance in the U.S. presidency (House, Spangler, & Woycke, 1991); and laboratory studies have shown that charismatic leader behavior was linked to higher individual and group performance than other leadership styles (Howell & Frost, 1989; Kirkpatrick & Locke, 1996). There is also relevant evidence from the research on transformational leadership, of which charisma is the most important element. Transformational leaders have been shown to have a strong effect on the followers' values, self-esteem, trust, confidence in the leader, and motivation to perform above and beyond the call of duty (Bass, 1990). A meta-analysis showed significant relationships between transformational leadership and effectiveness and, for our purposes here, that the specific charisma dimension of transformational leadership had stronger associations with the performance of managers in the firm than the other dimensions of transformational leadership (Lowe, Kroeck, & Sivasubramaniam, 1996).

To the best of our knowledge, there are only two systematic studies that address the relationship between firm performance and CEO charisma. In one study, Waldman, Ramirez, House, and Puranam (2001) examined the relationship between transactional and charismatic CEO leadership and financial performance in 48 Fortune 500 firms. They found that perceived charisma had only small *direct* relationships with performance, but did have larger associations under conditions of uncertainty. The other study, by Khurana (2002), examined the underlying "psychological" models that boards of directors used in the search and selection of 40 CEOs. The search criteria, he concluded, are articulated in terms of such critical selection criteria as the (1) current position of a candidate, (2) performance of a candidate in his or her current position, (3) stature of the candidate's firm, and ultimately, (4) charisma of the candidate. Using such criteria, the boards that he studied did not select CEOs who improved firm performance.

This theory and research form the bases for two hypotheses about CEO perceived charisma and firm performance. First, while theories of charismatic leadership imply that there should be direct associations of charisma with firm performance, the research to date indicates otherwise. To examine this notion, we hypothesized as follows:

Hypothesis 1. CEO charisma is positively related to firm performance.

The second hypothesis tests one of the central themes of charismatic leadership theory: charismatic leadership and associations with criteria are most likely to be present in crisis or at least highly uncertain situations (e.g. Bass, 1990; House et al., 1991; Waldman et al., 2001). The interaction of charisma and crisis or uncertainty occurs for two reasons (Bass, 1990). One is that a crisis or uncertain situation provides the context in which followers' need for direction increases the likelihood that the charismatic leader's personality will emerge. A second is that in conditions of uncertainty and crises, individuals feel the need for greater direction and guidance. Thus, we hypothesized as follows:

Hypothesis 2. The positive relationship between firm performance and CEO charisma is stronger under conditions of high uncertainty.

3. CEO compensation and charisma

Charismatic theory does not offer much guidance in the formulation of hypotheses about CEO compensation and charisma, although it seems logical that there should be reasons to expect such an association. Economists argue that CEOs, like other employees, are paid for their human capital. For a charismatic CEO, this includes both the conventional management skills that the CEO brings to a firm, as well as the charismatic capability to coordinate behaviors through a coherent “paradigm” and to instill a vision (Barnard, 1938; Hambrick & Fukutomi, 1991). Because boards of directors value these capabilities, we argue that more charismatic CEOs will be paid higher (Khurana, 2002). A second reason is that because the role of a CEO is complex and, we believe, has considerable ambiguity associated with it, charisma can be a signal or symbol (Meindl, 1990) used by compensation committees to predict the inherently ambiguous contribution made by the CEO to the firm. Therefore, we hypothesized as follows:

Hypothesis 3. CEO charisma is positively related to CEO compensation.

Uncertainty may also interact with CEO charisma to link with higher compensation. If a charismatic CEO, under conditions of uncertainty, can be seen as reducing the concerns of members, then this should be reflected in the CEO’s compensation. This happens because the ambiguity of crises and uncertainty increases the tendency of decision makers to rely on emotions, signals, symbols, language, and all other types of devices economizing rationality to guide their decisions. Furthermore, when conditions are highly uncertain, the specific CEO competencies necessary for success are unforeseeable. Charisma, as a proxy for leadership ability, may serve as the only basis for judging the potential success of a CEO, and is thus used by boards when assessing performance. In addition, “charismatic leaders engage in frame alignment . . . through their [language],” constructing schemata of interpretation that enable individuals to locate, perceive, and label occurrences within their life space and the world at large (Shamir, House, & Arthur, 1993, p. 29). Therefore, the board may view the charismatic CEO as someone who can deal with the complexity of the situation, and thus command a higher value to the firm under such conditions. Thus, we hypothesized as follows:

Hypothesis 4. The positive relationship between CEO charisma and CEO compensation will be stronger under conditions of high uncertainty.

4. Method

4.1. Subjects

The subjects were 59 CEOs in large U.S. firms (e.g., Fortune, 500) in 26 industries (see Appendix A for a complete list of the CEOs). We selected a random sample of 95 of the 929 firms listed on Disclosure in 1992 and sent a questionnaire to assess CEO perceived charisma and perceived environmental uncertainty in 1992 to 570 of the top managers in these 95 firms. We received 112 responses describing 59 CEOs (62%) of those in the

original random sample. For these CEOs, approximately 300 questionnaires were sent to their firms, and we had 112 responses from those surveyed in these firms, or an effective response rate of 37%. Data for firm performance, CEO compensation, as well as the control variables were obtained from Compustat, Compact Disclosure, and ExecuComp databases, as well as company proxy statements.

We assessed the possibility of nonresponse bias by testing differences in several factors used in the study for the 59 firms for which we had CEO charisma scores and the 36 nonresponding firms. We found no significant differences between these two groups of firms in sales, assets, return on investment, shareholder returns, CEO cash compensation, and CEO total compensation.

4.2. *Dependent variables*

The dependent variables were firm performance and CEO compensation. Data were collected for each year between 1988 and 1997 during which the targeted CEO was in place. These variables were standardized for industry by year (two-digit SIC classification) by converting the observations of performance and CEO compensation for each firm in each year to an industry *z*-score based on the mean and standard deviation of all of the firms in each industry as contained in Compustat (performance data) or ExecuComp (compensation data).

We used a market-based measure of firm performance and an accounting-based measure of firm performance. Both performance measures were examined separately, since they do not always converge to represent the same construct of firm performance (Fryxell & Barton, 1990). The market-based measure was *shareholder return*, measured as:

$$[(SP_{(t)} - SP_{(t-1)}) + DPS_{(t)}] / SP_{(t-1)}$$

where $SP_{(t)}$ is the year-end share closing price for year t , $SP_{(t-1)}$ is the year-end share closing price for year $t-1$, and $DPS_{(t)}$ is the annual dividends paid per share in year t (e.g., Jensen & Murphy, 1990; Murphy, 1985). The accounting-based measure of performance was *return on assets (ROA)* (e.g., McGahan & Porter, 1997).

CEO compensation was assessed using both CEO cash compensation and CEO total compensation. *CEO cash compensation* was the sum of salary plus annual bonuses, consistent with the vast majority of studies on CEO compensation (e.g., Finkelstein & Hambrick, 1989; Gerhart & Mickovich, 1990; Rajagopalan & Finkelstein, 1992). Bonuses did not vary significantly from year to year, and thus were more appropriately considered as a fixed component than as a form of contingent pay (Gerhart & Mickovich, 1990; Jensen & Murphy, 1990). *Total CEO compensation* consisted of cash compensation plus long-term compensation including long-term incentive pay, restricted and unrestricted stock grants, and stock options, consistent with previous CEO compensation studies (e.g. Hambrick & Finkelstein, 1995; Henderson & Frederickson, 1996; Jensen & Murphy, 1990). Stock options were valued using the Black–Scholes method. All long-term contingent pay including stock options was valued when granted. To adjust for inflation, compensation data were deflated to 1987 dollars using the CPI index (United States Department of Labor, n.d.).

4.3. Independent, moderator, and control variables

CEO perceived charisma was measured by the charisma scale of the Multi-Factor Leadership Questionnaire (Bass & Avolio, 1989). This scale contained items that assess both charismatic behaviors and charismatic attributions. Respondents rated the extent to which such items as “I have complete confidence in him/her” and “Gives reasons to be optimistic about the future” characterized the CEO of their firms. The reliability of this scale was .91. Between one and four responses about the CEO were received for each organization. We received two or more responses from top managers in 36 organizations, which were used to compute intraclass correlations ($ICC_1=.19$; $ICC_2=.32$) (Shrout & Fleiss, 1979) and within-group agreement indices (mean $r_{wg}=.85$; median $r_{wg}=.96$; standard deviation of $r_{wg}=.26$) (James, Demaree, & Wolf, 1993).

We measured environmental uncertainty perceived by top managers through their responses to a 10-item scale (Khandwalla, 1977) that was subjected to a principal components factor analysis that yielded two stable dimensions, one representing perceived political uncertainty and the other representing perceived market uncertainty. *Perceived political uncertainty* was assessed by the items “Government agencies are implementing changes in laws or policies which are becoming more unpredictable” and “The political situation of countries in which you have operations is becoming increasingly uncertain.” The interrater reliability of this factor was assessed by the intraclass correlation ($ICC_1=.22$) (Shrout & Fleiss, 1979) and within-group agreement index (mean $r_{wg}=.77$; James et al., 1993). The *perceived market uncertainty* factor consisted of three items (reversed scored): “Very predictable; easy to forecast the future state of affairs in the environment,” “Market activities of your key competitors have become more predictable,” and “Your customers’ demand for existing and/or new products has become more stable and predictable.” While the intraclass correlation was relatively low for this factor ($ICC_1=.04$), within-group agreement was sufficiently high to justify its use (mean $r_{wg}=.80$).

Firm size, related to both CEO charisma and compensation, was the control variable (Tosi, Werner, Katz, & Gomez-Mejia, 2000). Firm size was a composite index represented by the single factor resulting from a principal components analysis performed on two common measures of firm size, the natural logarithm of firm sales and the natural logarithm of employees, consistent with previous research.

4.4. Analytical method

The model specification incorporated both cross-sectional and time-series data. Since the independent and moderator variables (CEO charisma and perceived uncertainty, respectively) were based on surveys in 1992 and did not vary over time, a cross-sectional design was necessary to allow for variance in these variables. A longitudinal analysis was also necessary for the examination of CEO compensation as “cross-sectional models are inherently subject to a serious omitted variable problem” (Murphy, 1985, p. 12) because they cannot accommodate the inclusion of cross-period relationships (i.e., prior year firm performance) necessary for proper specification.

We included only those years between 1988 and 1997 for each firm during which the CEO targeted in the survey was in place. This time period was long enough to allow a sufficient amount of data to be included in the analysis for each CEO and should also have been long enough to avoid capturing only short-term effects, which are often a worry when studying firm performance. The net

effect of these choices was an unbalanced panel design that consisted of observations over time nested within firms (Hofmann, 1997). The number of observations over time for each firm varied between 4 and 10 years, with an average of slightly more than 8 years per firm, resulting in a total of 460 observations.

The data were analyzed using Hierarchical Linear Modeling (HLM, Bryk & Raudenbush, 1992). HLM's "intercepts as outcomes" (Bryk & Raudenbush, 1992) modeling allowed for a cross-sectional analysis of the relationship of CEO perceived charisma and its interaction with perceived uncertainty with each of the dependent variables while controlling for variables at the time level, consistent with their underlying theoretical framework. For example, the analysis of CEO compensation was done by regressing CEO compensation in time t of firm j on the control variables of prior year firm size, prior year firm performance, and prior year CEO compensation, as well as a time effect:

$$\begin{aligned} (\text{CEO Compensation})_{ij} = & \beta_{0j} + \beta_{1j}(\text{Time}) + \beta_{2j}(\text{CEO Compensation})_{t-1,j} + \beta_{3j}(\text{Firm Size})_{t-1,j} \\ & + \beta_{4j}(\text{Firm Performance})_{t-1,j} + \varepsilon_{ij} \end{aligned} \quad (1)$$

The time effect was coded such that the focal year (1992) for all firms was coded as a "0" with all other years symmetrically around it (1993 as "1," 1991 as "−1," and so on). Thus, the intercept, β_{0j} , represented the CEO compensation of firm j at time "0," or 1992 adjusted for time effects and the time-varying control variables (given "grand mean centering"; Hofmann & Gavin, 1998). The cross-sectional analysis was performed by simultaneously modeling this adjusted CEO compensation for each firm j (β_{0j}) as the dependent variable in the Level 2 model:

$$\begin{aligned} \beta_{0j} = & \gamma_{00} + \gamma_{01}(\text{CEO Charisma})_j + \gamma_{02}(\text{Perceived Uncertainty})_j \\ & + \gamma_{03}(\text{CEO Charisma} \times \text{Perceived Uncertainty})_j + \mu_{0j} \end{aligned} \quad (1a)$$

In other words, Eq. (1a) examined the relationship of CEO perceived charisma, perceived environmental uncertainty, and their interaction with 1992 CEO compensation properly adjusted for the time-level control variables. The analyses of firm performance, the other dependent variable, followed the same methodological approach.

5. Results

The simple correlation matrix is shown in Table 1 and indicates that CEO charisma was correlated with firm size ($r=.33, p<.01$). The magnitude of this relationship suggested that multicollinearity was not a concern (Bryk & Raudenbush, 1992); it did, however, point to the importance of including firm size as a control variable.

While the CEO charisma scores were somewhat left skewed, which would be expected in that some minimum level of charisma is likely to be attributed to a person in the role of CEO in the types of firms that were included in this study, none of the other variables departed from the assumption of normality.

We found no evidence of auto-correlation in any of the models using standard tests on the models of CEO compensation (Durbin's m -test; see Kmenta, 1986) and of firm performance (Durbin–Watson test;

Table 1
Correlations among variables ($N=59$)

Variable	Mean	SD	1	2	3	4	5	6	7	8
1. CEO charisma ^a	4.38	0.58	1.00							
2. Shareholder value ^a	0.38	0.44	.11	1.00						
3. Return on assets ^a	0.26	0.24	.18	.26*	1.00					
4. Total CEO compensation ^a	1.54	2.18	.26*	.08	.24	1.00				
5. CEO cash compensation ^a	1.31	1.19	.17	.13	.33*	.60**	1.00			
6. Perceived political uncertainty ^b	-1.39E-16	1.00	-.12	-.23	.02	.00	-.04	1.00		
7. Perceived market uncertainty ^b	-7.20E-17	1.00	.04	-.14	.13	.02	-.03	.00	1.00	
8. Firm size (factor)	8.48	0.99	.33*	.12	.12	.26*	.36**	.08	.04	1.00

Based upon cross-sectional data.

^a Variables are standardized around industry means $\sim N(0,1)$.

^b Variables have been normalized around mean of 0.

* Correlation is significant at the $p < .05$ level (two-tailed).

** Correlation is significant at the $p < .01$ level (two-tailed).

see Greene, 1997). The robust standard errors automatically generated by HLM were used, as these correct for such departures from the assumptions of the variance–covariance matrix (Raudenbush, Bryk, Cheong, & Congdon, 2000).

Table 2
CEO charisma and firm performance ($N=59$)

Model	Shareholder return				Return on assets			
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Intercept	0.39*** (0.06)	0.39*** (0.06)	0.39*** (0.06)	0.39*** (0.06)	0.26*** (0.03)	0.26*** (0.03)	0.26*** (0.03)	0.26*** (0.03)
Time	-0.02 (0.02)	-0.02 (0.02)	-0.02 (0.02)	-0.06 (0.02)	-0.00 (0.01)	-0.00 (0.01)	-0.00 (0.01)	-0.00 (0.01)
Firm size	0.05 (0.05)	0.04 (0.05)	0.04 (0.05)	0.05 (0.05)	0.03 (0.02)	0.01 (0.02)	0.02 (0.03)	0.02 (0.02)
CEO charisma		0.01 (0.01)	0.01 (0.01)	0.01 (0.01)		0.01 (0.01)	0.00 (0.01)	0.01 (0.01)
Perceived political uncertainty			0.17 (0.44)				-0.39* (0.19)	
Charisma \times Perceived political uncertainty			-0.01 (0.01)				0.01 (0.01)	
Perceived market uncertainty				-0.69*** (0.16)				-0.28 (0.22)
Charisma \times Perceived market uncertainty				0.02*** (0.00)				0.01 (0.01)
LR ratio (χ^2)	10.99*	11.15*	13.44*	14.42*	36.92***	38.63***	42.33***	42.97***

Note. Robust standard errors in parentheses.

* Significant at $p < 0.05$, two-tailed test.

** Significant at $p < 0.01$, two-tailed test.

*** Significant at $p < 0.001$, two-tailed test.

Tables 2 and 3 report the regression coefficients of the analyses examining the relationships of CEO perceived charisma and the uncertainty measures with the dependent variables. Both tables were constructed similarly. That is, Model 1 included all of the control variables pertinent to the particular model, Model 2 then added the CEO charisma variable, and then each uncertainty measure was added individually along with the interaction between CEO charisma and the respective moderator measure in subsequent models. All Level 1 control variables were modeled as varying randomly across firms. The measure of model fit is reported in the form of the statistic produced using a likelihood ratio (LR ratio) test comparing the respective model to the null model (no predictors), which has a χ^2 distribution (Bryk & Raudenbush, 1992).

There was no support for Hypothesis 1 that CEO charisma is positively related to firm performance, whether assessed by shareholder return or return on assets (see Table 2, Panel 1 for shareholder returns and Panel 2 for ROA).

The tests for Hypothesis 2, the interaction effects of uncertainty and charisma on firm performance, are reported in Models 3 and 4 in Table 2. We found that there was no significant moderating effect of either type of uncertainty on return on assets (Table 2, Panel 2). However, the interaction of charisma and perceived market uncertainty was significantly related to shareholder return ($p < .001$; Table 2, Panel 1, Model 4). The effect size of this finding was relatively small ($r = .088$, or 0.77% of the total variance),

Table 3
CEO charisma and CEO compensation (N=59)

Model	Total compensation				Cash compensation			
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Intercept	1.60*** (0.23)	1.58*** (0.22)	1.57*** (0.21)	1.59*** (0.21)	1.28*** (0.05)	1.28*** (0.05)	1.28*** (0.04)	1.28*** (0.05)
Time	0.07 (0.08)	0.08 (0.08)	0.08 (0.08)	0.08 (0.08)	0.04* (0.02)	0.04* (0.02)	0.04* (0.02)	0.04* (0.02)
CEO compensation _(t-1)	0.23*** (0.04)	0.22*** (0.06)	0.21*** (0.06)	0.21*** (0.06)	0.65*** (0.05)	0.65*** (0.05)	0.65*** (0.05)	0.64*** (0.05)
Firm size _(t-1)	0.14 (0.25)	0.01 (0.28)	-0.01 (0.28)	0.03 (0.28)	0.12* (0.04)	0.11* (0.04)	0.10* (0.04)	0.12* (0.05)
Firm performance _(t-1)	0.01 (0.09)	-0.01 (0.09)	-0.01 (0.10)	-0.01 (0.09)	0.04 (0.03)	0.04 (0.03)	0.03 (0.03)	0.04 (0.03)
CEO charisma		0.09* (0.04)	0.10* (0.04)	0.08* (0.04)		-0.00 (0.01)	0.01 (0.01)	0.00 (0.01)
Perceived political uncertainty			1.05 (0.88)				0.44* (0.20)	
Charisma × Perceived political uncertainty			-0.03 (0.02)				-0.01* (0.01)	
Perceived market uncertainty				-1.64 (0.94)				-0.12 (0.17)
Charisma × Perceived market uncertainty				0.04 (0.02)				0.00 (0.01)
LR ratio (χ^2)	37.49***	40.84***	41.17***	41.59***	204.24***	204.37***	207.98***	204.66***

Note. Robust standard errors in parentheses.

* Significant at $p < 0.05$, two-tailed test.

** Significant at $p < 0.01$, two-tailed test.

*** Significant at $p < 0.001$, two-tailed test.

however, this result suggests a sizeable potential impact on real wealth creation. Given the average return for the shareholders of the 59 firms in our sample in 1992 (0.15, $SD=0.18$), and considering that the total market value for the same companies was just over US\$513 billion for that year, this effect size could account for approximately US\$130 million worth of wealth creation (in just this one year). In other words, it appeared that perceived charismatic leaders running companies in highly uncertain environments had the potential to create a considerable amount of wealth for their shareholders, despite the fact that these same CEOs did not outperform their less charismatic peers on the accounting-based measures of performance (ROA).

Table 3 reports the results of analyses of perceived charisma and CEO compensation. We found no relationship between CEO charisma and cash compensation (Table 3, Panel 2, Model 2), but demonstrated that charismatic CEOs (Hypothesis 3) earn more total compensation than their industry peers with less charisma ($p < .05$; Table 3, Panel 1, Model 2). Again, while the effect size of this finding was relatively small ($r=.092$), its impact could be considerable. Given the average total compensation for the 59 CEOs in our sample for 1992 (US\$3.2 million, $SD=US\$3.7$ million), this effect size suggests that companies with charismatic leaders paid premiums totaling approximately US\$120 million that year to these CEOs.

The tests for the interaction effects of perceived charisma and uncertainty on compensation (Hypothesis 4) are also reported in Table 3 (Models 3 and 4). Only the political uncertainty/charisma interactions were significant. Political uncertainty moderated the relationship between CEO cash compensation and CEO charisma, such that the relationship was lower when political uncertainty was high ($p < .01$; Table 3, Panel 2, Model 4). While the effect was significant, the effect size of this finding was small relative to the other findings (effect size $r=.046$), and accounts for only approximately US\$4 million spent on CEO cash compensation for that year (out of a total of over US\$80 million).

6. Discussion

Our results, studying 59 CEOs from among the largest firms in the United States, combined with other systematic studies of CEO charisma (Khurana, 2002; Waldman et al., 2001), suggested that boards should be a bit more circumspect in advocating charisma as a criterion for the selection of CEOs. We found no significant direct relationships between CEO charisma and firm performance; yet, overall, charismatic CEOs extracted compensation premia in the form of higher total pay. There were associations between CEO charisma and market measures of performance under conditions of uncertainty, as theory predicted (Shamir et al., 1993) and some research demonstrated (e.g., Pillai & Meindl, 1991; Waldman et al., 2001). Fig. 1 shows that with low perceived market uncertainty, shareholder returns were similar regardless of the level of CEO charisma.

However, in uncertain market conditions, equity markets placed value on CEOs perceived to be highly charismatic. These CEOs were able to boost the stock price, even though there was no evidence that these firms were internally managed better, as measured by return on assets (see Table 3, Model 2). Apparently, while equity-holders value charismatic leadership in uncertain situations, such leadership was not significantly associated with greater internal performance (ROA). The effects on shareholder return were an important finding because "... market value maximization is ... the proper test of performance... if the firm is to be managed in the best interests of the equity holders, [since] it can be

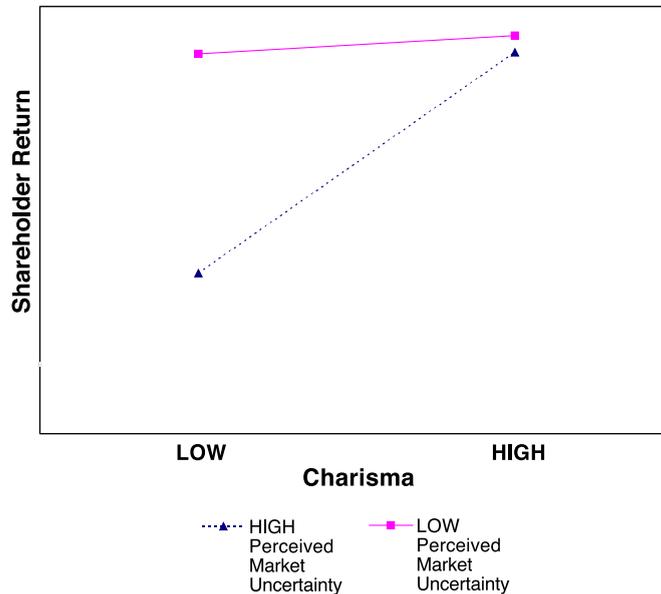


Fig. 1. Shareholder return and interaction of CEO charisma and perceived market uncertainty ($N=59$).

assumed that market value of the firm at any point reflects the best estimates of the future cash flows that the firm will generate” (Milgrom & Roberts, 1992, p. 436).

These results suggested that it might be an overgeneralization to interpret the assertions of Collins (2001) and Khurana (2002) to mean that there is no room for charismatic CEOs. What we mean to say is this: it might hold that for Collins the firms studied did move from “good to great,” and that there was no charismatic leadership, but it may be that the “good” firms that become “great” were not in the sort of crises or highly uncertain situations in which charismatic leaders might be effective. Similarly, Khurana made the point that the use of charisma as a selection criterion did not result in any significant performance effects. Here, too, it is possible that the cases he studied, in general, were not of firms in crises or highly uncertain situations. For us, this suggests that an important boundary condition for charismatic theory, applied to CEO leadership, is the existence of crises (see Hunt, Boal, & Dodge, 1999) or highly uncertain situations (see Waldman et al., 2001).

CEO charisma did presumably play a role in the design of CEO compensation contracts. First, even though we find no direct relationships with performance, CEOs who were perceived to be more highly charismatic received higher total pay than their industry counterparts, controlling for firm size and prior performance. One explanation for these findings is that the charismatic CEO was powerful enough to influence boards of directors in ways that led to higher pay in spite of firm performance (Tosi & Gomez-Mejia, 1989). To test this notion, we examined the effects of some conventional indicators of the CEO power relationship with boards of directors by examining the relationships among CEO charisma and both measures of pay, controlling for board governance proxies that are relatively well-accepted measures of CEO power relative to the power of the board (e.g., ratio of outside board members to total board members and stockholder equity concentration) (Rediker & Seth, 1995). We found (unreported here) that neither variable had any significant relationship with CEO pay.

A second explanation is the romance of leadership phenomenon (Meindl, Erlich, & Dukerich, 1985). This would mean that the charismatic attributions could have been a result of the tendency to overestimate the role of the person (i.e., the CEO) relative to the context as the cause of an outcome (Ross, 1977). Thus, it is entirely possible that the top managers who rated the CEOs may have made charismatic attributions to the CEO who was already highly paid, when stock prices were high, when the firm was large, or if the CEO was very powerful, facts perfectly consistent with what one would expect from a charismatic CEO (Meindl et al., 1985; Puffer & Weintrop, 1991). In addition, boards of directors, as Khurana (2002) found, may have believed that firms were, indeed, better off under more charismatic CEOs and willing to reward them with long-term incentives and favorable stock options. This could be because managerial ability, itself, is unobservable to boards of directors, so boards may design compensation contracts to attract and retain those whom they believe will be the “best” managers while preventing the less able from applying or forcing them to resign (Raviv, 1985).

We conducted an indirect, post hoc analysis to provide some additional insight on the romance of leadership explanation. We tested the “Dow Jones Index (DJI) effect,” reasoning that CEOs of the largest, most well-known firms would be more likely to be viewed as charismatic as opposed to those whose firms were not listed. We found no relationship between charisma scores and the DJI listing, or the dependent variable, change in stock price.

The association of the interaction of political uncertainty and charisma with cash compensation was also consistent with the romance of leadership interpretation (see Fig. 2). Charismatic CEOs received higher cash compensation than their peers when political uncertainty was perceived to be low, but received lower cash compensation under conditions of high political uncertainty. This finding could imply that CEO compensation contracts under conditions of political uncertainty contained a greater proportion of contingent pay and attract those candidates perceived to be more able, that is, charismatic. In contrast, less charismatic CEOs may have only accepted contracts with a greater degree of cash compensation under such conditions, as they were less confident in their

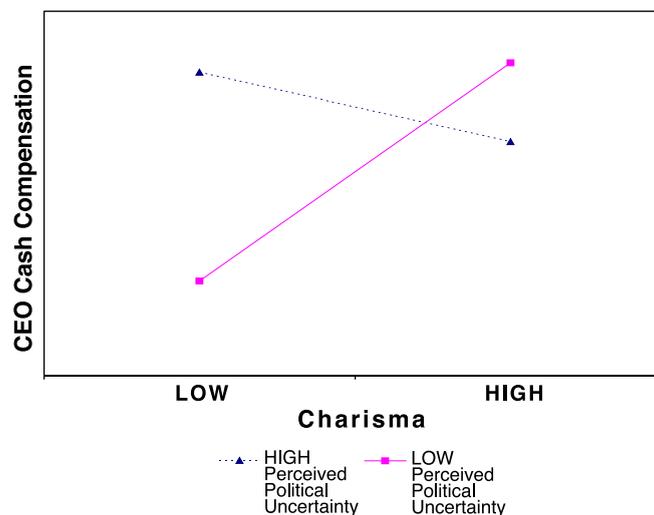


Fig. 2. CEO cash compensation and interaction of CEO charisma and perceived political uncertainty ($N=59$).

abilities to succeed in the face of political uncertainty. When political uncertainty was low, the more charismatic CEOs commanded higher cash compensation than their less charismatic peers.

6.1. *Some critical caveats*

There are some important caveats to note:

1. The sample size was relatively small, providing limited degrees of statistical freedom, and required that we be both sparse and judicious in the specification of the variables in our statistical models.
2. Obtaining the perceived charisma data for the CEOs in our sample was extremely difficult in that we had to rely on responses from members of the top management team, executives whose workday is quite full. This resulted in a situation in which, for 25 of the 59 firms in the study, only one respondent assessed the charisma of the CEO. While the intraclass correlations were quite reasonable for CEOs in the other 36 firms with two or more respondents, we may have a less accurate view of perceived charisma of CEOs in firms from which we have only one respondent, implying the need for care in interpreting the results.
3. It is a “long way” between CEO charismatic leadership, as perceived by the top management team, and firm performance and compensation, and there are intervening processes that affect these relationships (Cannella & Monroe, 1997; Waldman & Yammarino, 1999). We could not assess any of these processes, or other, intervening dimensions because our data were gathered from only subjects at the highest organizational levels, who have limited time, as well as perhaps limited knowledge of intervening processes and variables at lower organization levels.
4. There are several reasons why our effect sizes seem important, even though they were small. One, as Prentice and Miller (1992) argued, judgments about the “importance of effect sizes are...highly subjective” (p. 163). Two, they stated, that small effects may have theoretical importance as, we argued, is the case of CEO perceived charisma because there is so little empirical evidence of the conventional belief that charismatic CEOs can produce important results for firms. Three, they indicated, “small effects in ongoing processes may accumulate over time and become large” (p. 164) as can be the instances of increases in both shareholder wealth and CEO pay over time. Four, they make the case that a small effect size can be important when the “dependent variable seems especially unlikely to yield to influence from the independent variable” (p. 163). We think this is especially relevant because, as we noted above, there were a wide range of intervening factors (cf. Cannella & Monroe, 1997; Waldman & Yammarino, 1999) between the CEO’s charisma and firm performance that are shrouded in the “black box” of the organization that could mitigate against the CEO’s impact.

Thus, these caveats notwithstanding, we believe this was a unique sample of 59 CEOs from among the largest firms in the United States that most accurately represented the sort of charismatic CEOs to which we normally allude, and it does provide some insights to how charisma operates at the highest levels of U.S. firms. And, the fact that it is a “long way” between CEO charismatic leadership and firm performance and compensation is a reason to take these effect sizes seriously.

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Appendix A. Study subject list

Company	CEO (# years in study)	Company	CEO (# years in study)
Alexander & Alexander Services, Inc.	Tinsley Irvin (7)	Harsco Corp.	Malcolm Gambill (6)
Alltel Corp.	Joe Ford (10)	Hershey Foods Corp.	James Zimmerman (5)
Aluminum Company of America	Paul O'Neill (10)	Home Depot, Inc.	Bernard Marcus (9)
American Brands, Inc.	William Alley (7)	Johnson & Johnson	Ralph Larsen (9)
American Home Products Corp.	John Stafford (10)	Kelly Services, Inc.	Terence E. Adderley (9)
American Telephone & Telegraph Co.	Robert Allen (8)	Kmart Corp.	Joseph Antonini (7)
AMR Corp.	Robert Crandall (10)	Long Island Lighting Co.	William Catacosinos (8)
AON Corp.	Patrick Ryan (10)	Mapco, Inc.	James Barnes (9)
Apple Computer, Inc.	John Sculley (4)	Masco, Corp.	Richard A. Manoogian (10)
Asarco, Inc.	Richard Osborne (10)	Mattel, Inc.	John Amerman (9)
Ashland Oil, Inc.	John Hall (8)	Motorola, Inc.	George Fisher (5)
Atlantic Richfield Co.	Lodwick Cook (6)	Pepsico, Inc.	D. Wayne Calloway (8)
Avon Products, Inc.	James Preston (9)	Polaroid Corp.	Israel Booth (7)
Baker Hughes, Inc.	John Woods (8)	Raytheon, Co.	Dennis Picard (8)
Bausch & Lomb, Inc.	Daniel Gill (8)	Reebok International, Ltd.	Paul Fireman (10)
Becton Dickinson & Co.	Raymond Gilmartin (5)	Sara Lee Corp.	John Bryan (10)
Bellsouth Corp.	John Clendenin (8)	Scott Paper Co.	Philip Lippincott (6)
Boeing Co.	Frank Shrontz (8)	Sherwin Williams Co.	Edward Breen (10)
Caterpillar, Inc.	Donald Fites (7)	Texaco, Inc.	James W. Kinnear (5)
CBS, Inc.	Laurence Tisch (7)	Texas Instruments, Inc.	Jerry Junkins (8)
Chevron Corp.	Kenneth Derr (9)	Toys R Us, Inc.	Charles Lazarus (6)
Chubb Corp.	Dean O'Hare (9)	Turner Broadcasting System, Inc.	Clyde Turner (8)
CMS Energy Corp.	William McCormick (6)	Union Electric Co.	William Cornelius (6)
Columbia Gas System, Inc.	John Croom (7)	Vons Cos., Inc.	Roger Stangeland (6)
Computer Sciences Corp.	William Hoover (7)	Waste Management, Inc.	Dean Buntrock (8)
Duke Power Co.	William Lee (6)	Wells Fargo & Co.	Carl Reichardt (7)
Enron Corp.	Kenneth Lay (10)	Westvaco Corp.	John A. Luke, Jr. (6)
First Of America Bank Corp.	Daniel Smith (8)	Whirlpool Corp.	David R. Whitman (10)
General Electric Co.	Jack Welch (10)	Xerox Corp.	Paul Allaire (7)
General Mills, Inc.	H. Brewster Atwater, Jr. (7)		

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