



RAKESH KHURANA

The Cult of the Charismatic CEO

by CRAIG LAMBERT

IN 1997, ONE OF THE BLUE-CHIP ICONS OF corporate America, AT&T, was in trouble and seeking a new leader. The company was operating in a deregulated industry and facing declining profit margins in its core business—long-distance telephone service. After a three-month search, the board of directors passed over a well-regarded insider, John Zeglis, who was intimately familiar with the complexities of the deregulated business environment, and instead hired C. Michael Armstrong as CEO. After a 31-year career with IBM, Armstrong had headed Hughes Electronics, a defense contractor with interests in satellite television, with great success for four years. Business magazines showed

him astride his Harley Davidson motorcycle, a knight on an iron steed riding in to save the telecommunications giant.

“The selection of a celebrity CEO can drive up the market value of a company’s stock,” says assistant professor of business administration Rakesh Khurana, Ph.D. ’98, whose new book, *Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs* (Princeton University Press) explores the messianic mania surrounding such hires. Indeed, the day Armstrong was selected, the market value of AT&T stock went up \$4 billion. The AT&T board also lavished money on Armstrong; in 2000, his compensation was reportedly \$21.8 million, and perks included

a \$10-million guaranteed price on a block of his restricted stock.

Armstrong embarked on an aggressive program of acquisitions—cable TV, cellular telephony, and Internet delivery systems—as part of his vision of remaking AT&T into an omni-Internet corporation. That strategy has tanked, and AT&T is now selling off those acquisitions at huge losses. The stock, which peaked at about \$64 per share in 1999, is currently priced at around \$10. “The company today looks very much like it did when Mike Armstrong walked in—a formerly regulated company with declining margins in its core long-distance telephone business,” says Khurana. “Except this: four years ago AT&T had \$6.7 billion in debt; today its indebtedness is \$67 billion. Its balance sheet, which had been one of the healthiest in the country, is now one of the worst.” (On July 17, AT&T announced that Armstrong is leaving to become chairman of the corporation formed when Comcast Corporation bought AT&T’s cable-television business; AT&T took a \$13-billion charge for the sale.)

Yet AT&T is far from the worst case. The unravelings of Enron, Tyco, and WorldCom have raised searching questions about corporate leadership and even shaken investors’ faith in corporate America. These debacles have revealed incompetent, unethical, and massively self-serving individuals atop corporations. Is this a group of bad apples who all went rotten at once, or—more worrisome—do these executives typify leaders at Fortune 1000 companies? Khurana, who earned his doctorate in organizational behavior, studying under a joint program of the sociology department and Harvard Business School, suggests that a corporate trend toward hiring “charismatic” CEOs, rather than competent executives with relevant skills, may help explain the anguish that now afflicts so many firms.

Drawing on interviews with CEOs, board members, and executive search consultants, plus extensive data on the country’s 850 largest public corporations, Khurana—who was himself a manager with Cambridge Technology Partners for four years—asserts that the CEO labor market “is not really a market. A genuine market means many people transacting anonymously and efficiently, with the guiding factor that no single actor has enough power to set the terms of the exchange. But CEO jobs are a small-numbers market: there are only a few positions, and only a small number of candidates *perceived* to have the skills needed to run a large corporation.” In a typical year, 90 to 140 CEO positions open up in the largest 850 companies, the vast majority due to normal retirements. One-third of new CEOs hired are outsiders.

But the path to the top has changed. In the past, management controlled the succession process: the new top dog was almost always promoted from within the kennel, typically hand-picked by the outgoing CEO with a rubber stamp from the board of directors. (In fact, the CEO often chose the membership of the board, which became a highly self-replicating group.)

Then, gradually, the structure of corporate ownership changed, as stock became increasingly concentrated in the hands of institutional investors. In 1950, less than 10 percent of U.S. equities were owned by institutions (such as mutual funds and pension funds), but today, institutions control about 60 percent

of corporate stock. In the 1980s, dismayed by declining profitability, these big investors sought to dislodge entrenched management corps, which were seen as an insular, self-satisfied, underperforming group. These major stockholders financed leveraged buyouts by private equity firms like Kohlberg Kravis Roberts (KKR) and threw out previous management. When states passed anti-takeover laws, the investors shifted their focus to boards of directors.

Using the business media, investors pressured boards to monitor CEO performance more diligently. They publicized lists of the “Ten Worst Corporate Boards” and took out full-page ads in the *Wall Street Journal* criticizing specific boards and companies. “The message was: ‘We will shame you,’” says Khurana. “The hot and searing kind of shame that makes people at the country club look at you askance.” Investors worked together to elect their own directors, and at places like Kodak, General Motors, and Westinghouse, boards began firing CEOs with a vengeance. At the largest 200 to 300 companies, up to 50 percent of CEOs were discharged.

The trend toward charisma may have started when “the idea took root that if a firm was doing poorly or well, it was because of the CEO,” Khurana explains. “Previously, CEOs were about as well-known as their chauffeurs. But something happened when Lee Iacocca was credited with single-handedly saving an American icon. Most people forgot about the \$2-billion federally guaranteed loan to bail out Chrysler, or the United Auto Workers’ givebacks. Iacocca made other CEOs look bland—there was even talk of drafting

him for president. The image of a CEO changed from being a capable administrator to a *leader*—a motivating, flamboyant leader with a new task. In the late 1980s and early ’90s, business tried to redefine itself; it was no longer about the profane task of making money, but concerned with vision, values, mission—essentially religious terms.”

This meant “importing the sacred into the profane,” explains Khurana, who uses the German sociologist Max Weber’s works on charisma as a touchstone. Charismatic leadership, which grows from a personal magnetism that inspires devotion, reaches its apotheosis in religious cults. Its ascendance in corporate life is “a throwback to an earlier form of authority that proved to be very unstable,” says Khurana. “Weber said that charisma and rationality cannot coexist. The progress of Western civilization has been a movement away from charismatic leadership toward rational authority invested in laws and institutions. After Hitler and Mussolini, Americans were rightly skeptical of charismatic leaders. Separating the individual from the office is one of the great victories of Western society.”

Yet in corporate America, the personalities of CEOs have been conflated with the success or failure of the companies where they work. “The only explanation needed for General Electric’s performance is Jack Welch,” says Khurana, noting that GE’s 300,000 employees in hundreds of divisions within many subsidiary companies are omitted from the equation. “Under Jack Welch, GE had a stunning run of profit growth—almost 80 straight quarters,” he continues. “Given the complexity of (please turn to page 97)

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TESTING TRAP (continued from page 37)

students' ethnic and economic backgrounds. But such measures are highly unreliable for populations the size of a typical elementary school, and they are particularly unreliable for even smaller sub-groups of students. Schools are often misclassified as low- or high-performing purely because of random variation in their test scores, unrelated to any educational factor.

The standards and accountability movement is in danger of being transformed into the testing and accountability movement. States without the human and financial resources to select, administer, and monitor tests are now being forced to begin testing at all grade levels. Instead of creating academic standards that drive the design of an appropriate assessment, low-capacity states will simply select a test based on its expense and ease of administration, making charges of "teaching to the test" increasingly accurate. A test with no external anchor in standards or expectations about student learning becomes a curriculum in itself, trivializing the whole idea of accountability.

THE ENTHUSIASM FOR performance-based accountability plays to the worst weaknesses of the American education system. After World War II, most industrialized countries nationalized their education systems, but not the United States. Because decisions about content and performance were left to states and localities for so long, they never developed the capacity to monitor the quality of teaching and learning in schools, to support the development of teachers' and administrators' knowledge and skill, or to evolve measures of performance that are useful to educators and the public.

The difficult, uneven, and protracted slog toward clearer expectations and supports for learning has barely begun in most states and localities. The history of federal involvement in that long effort is mixed at best. The current law repeats all of the strategic errors of the previous law, but with greater federal intervention. The prognosis is not good.

The best we can hope for is that the capacity problems of states and localities will become more visible as a political issue, triggering responses that will help schools overcome the real obstacles they

face in improving the quality and intensity of teaching and learning. Similarly, we can hope that the technical failures of testing will trigger a response that focuses more on broad assessments of student learning.

The worst that can happen is that test-based accountability will widen the gap between schools serving the well-off and those serving the poor, thus confirming the public's suspicion that expecting high levels of learning from all children is unrealistic. Performance-based accountability in education is mutating into a caricature of itself. ▽

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CHARISMATIC CEOs

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business, it is extremely unlikely for that to happen without taking accounting liberties. But to raise that as an issue was almost sacrilege at GE—because it would call into question charismatic authority."

Khurana's research does question such authority; he

finds no evidence for a stable "CEO effect." It turns out that the person at the top matters less than the relevant business conditions. Technological change, for example, has pushed Kodak and Polaroid (now in bankruptcy) into the digital-photography market, where profit margins are only one-tenth those in their older business of chemical photography. As Warren Buffett said, "When you put a good manager into a bad business, it's usually the reputation of the business that remains intact."

CEOs' Celebrity Compensation

WITH THE AVERAGE CEO's pay topping \$10 million in 2001, according to the *New York Times* (see graphic at left), stock options have become an increasingly important form of compensation. They now represent 13 percent of all corporate liabilities. Executives like Al "Chainsaw" Dunlap (formerly of Scott Paper and Sunbeam) have argued that CEOs' far-reaching impact justifies such lavish compensation. But Rakesh Khurana's research finds no evidence for a stable "CEO effect." The assistant professor of business administration notes that "CEOs like to compare themselves to sports stars and celebrities. But unlike sports stars, the value of what CEOs produce depends on the efforts of tens of thousands of other individuals."

Though not always. In December 2000, after a year when AT&T cut its dividend for the first time in its history and saw its stock price nose-dive from \$60 per share to \$18, the company's board asked CEO Mike Armstrong to wait outside the room as they conducted his annual performance review. *Business Week* reported that when he returned an hour later, the board "exploded with a standing ovation."

Yes, charisma can be bulletproof—by definition, it is impervious to rationality. Even so, charismatic authority is a precarious, profoundly vulnerable thing, as history has repeatedly proved. And, as Khurana asserts, allegiance to charismatic leaders is in fact antithetical to an open society. The atavistic corporate quest for charismatic CEOs, with its deference to the personality and vision of a particular individual, comes bundled with risks of abuse, misconduct, and incompetence. The results are now spread before us, and their name is not Legion, but Enron. ▽

Craig A. Lambert '69, Ph.D. '78, is deputy editor of this magazine.

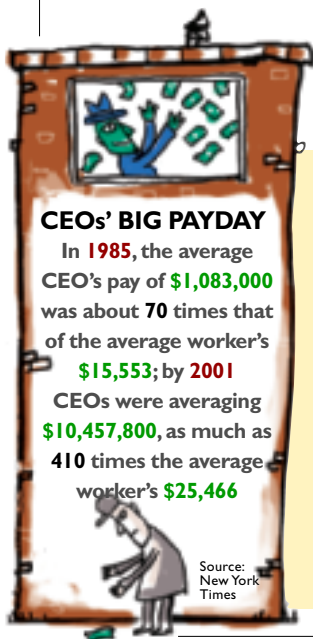


Illustration by Stephen Anderson