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Why long-tenured CEOs fail? The case of Nissan – Egor Matveyev

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When is it time to get a new CEO? This is the question that every board of directors asks – or at least has to ask – itself every year when evaluating performance of their CEOs. While we know that CEOs get fired for really bad performance, most of the time performance is not bad enough to justify such a drastic measure. On top of that, what are the guarantees that the new CEO will be any better? Therefore, the default choice is to stick with the current CEO.

If we could identify who is a good CEO and who is a bad one, then replacement decisions would be easier. But in practice, it is a very difficult task. In my recent work with co-authors, we tried to address this question. We use state-of-the-art methodology and a large sample of CEOs to identify who is good and who is bad. Of all possible predictors of CEO quality, three factors emerged to have the strongest predictive power. These factors are CEOs' age, tenure, and founder status. In our study, we define young CEOs as those whose age is below 58 and old CEOs as those whose age is above 65. Short-tenured CEOs are those who have been in the office for less than 8 years, and long-tenured – above 18 years. (These cutoffs – 58 and 65 for age, and 8 and 18 for tenure – are tercile breakpoints for age and tenure in our sample.)

We find that young CEOs tend to be good on average. They account for more than 4% of the market value of their firms. This means that if they leave, firm value drops by 4% on average. On the other hand, old and long-tenured CEOs tend to be bad. They destroy more than 3% of firm value, which means when they leave, firm value rises by as much as 3%. Among founder-CEOs, the age and tenure effects are even stronger. Young founders account for almost 9% of firm value, while old and long-tenured founders destroy more than 5%. These differences are striking. Our study is the first one to document such strong and heterogeneous age and tenure effects.

So why old and long-tenured CEOs are bad? A recent case in point is Carlos Ghosn, the Chairman and CEO of Renault–Nissan–Mitsubishi Alliance. Mr. Ghosn started his job in June 2001, which means he has been in the office for more than 17 years by the time he got arrested. What typically happens over extended tenures, such as Mr. Ghosn's, is that CEOs entrench themselves. Boards become co-opted and CEOs become less accountable for the actions they take. In Mr. Ghosn case, he has been charged with under-reporting his compensation, which allegedly violated laws of Japan.

Entrenchment is usually also accompanied by extraction of other private benefits. Mr. Ghosn was known for his lavish lifestyle. Nissan, for example, has spent 15 million USD to acquire and renovate a mansion in Beirut used exclusively by Mr. Ghosn. Another example is the Gulfstream G650 jet acquired by Nissan for Mr. Ghosn's use. This jet is equipped with a bedroom, and has a price tag of $64.5 million, according to Corporate Jet Investor. Perhaps the most famous example of entrenched CEO living extravagant lifestyle was Ross Johnson of RJR Nabisco, which was famously acquired by KKR in 1988 in what is still the world's largest leveraged buyout ever completed. Mr. Johnson had a fleet of 36 jets, to which he famously referred to as "RJR Air Force."

But the issue is not just high compensation and private benefits. CEOs who stay in the office for too long tend to become less innovative, less adaptable, and tend to lose competitive battles with firms led by younger CEOs. This is perhaps unsurprising. CEOs who are able to stay in the office for very long and entrench themselves, usually have been great in the past, which is why boards trust them. But because these CEOs have been great in the past, does not mean they are the best choice at present. In other words, there is an optimal "stopping point," at which a firm should find a new, younger CEO.

In practice, removing and replacing longer-tenured CEOs is very difficult. There will undoubtedly be many voices to argue their case and to explain to shareholders that there is no viable alternative, and that there are no guarantees that the new CEO will be better. In Mr. Ghosn's case, if it was not for overspending and alleged underreporting of pay, it was unthinkable that he could have voluntarily stepped down or would otherwise have been peacefully removed. This underscores the difficulty of changing management in modern corporate governance practices.

If we have shareholders' best interests in mind, it would be productive to initiate a discussion on creating term limits for CEOs, as well as more stringent performance reviews for older and longer-tenured executives. After all, even country presidents have term limits. And if Carlos Ghosn have stepped down from his post several years earlier, there would have been no damage caused to Renault–Nissan–Mitsubishi; or at least this damage would have been smaller than it is right now.

Read the Japanese post at Nikkei Business Online.

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