



When CEO lack of foresight hurts firm performance

Increasing CEO myopia is affecting executives' ability to create long-term value. Over the past 20 years, the average CEO tenure fell from eight years to less than four years and CEOs are under growing pressure to produce quick results. This short-term focus is undermining their company's long-term performance and stakeholder relationships.

Murad Antia, Christos Pantzalis (both University of South Florida) and Jung Chul Park (Louisiana Tech University) explored the relationship between CEO expected tenure and firm outcomes such as financial performance, information risk and costs. They compared CEO age and tenure with the industry norm across 1,500 S&P firms between 1996 and 2003, accounting for the impact of compensation packages on expected tenure.

The research team found that:

- Shorter CEO decision horizons create additional investment costs. Why? Executives may invest in projects that serve their own interests rather than those of the company, especially when the company's future growth opportunities are poor.
- Shorter CEO decision horizons increase information risk. Prior to turnover, CEOs tend to manage corporate earnings with the goal of raising stock prices and securing seats on corporate boards. This reduces the quality of information investors get about earnings and cash flows.
- Longer CEO decision horizons are associated with better firm performance: long-term oriented CEOs lead their firms to exceptional performance and high-performing firms tend to hire long-term oriented CEOs. These long-term oriented CEOs were either young or expected to hold their positions longer than other CEOs in their industry.
- CEOs with more unexercised stock options tended to have shorter decision horizons.

So what are firms to do? The authors suggest that hiring a young CEO is not the entire answer. Instead, firms should focus on designing compensation packages that expand executive decision horizons and discourage opportunistic behaviour. Relying heavily on stock options may not avert myopia – executives with shorter decision horizons simply won't exercise the options.

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Another solution, which warrants additional research, could lie within the managerial labour market. Since CEOs will make shorter-term decisions as they approach retirement, the availability of post-retirement employment opportunities such as board seats could keep them focused on longer-term opportunities.