Learning a Lesson in Executive Selection

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The English philosopher Gilbert Ryle famously distinguished between two forms of knowing. The first involves knowing *that* something is the case and concerns factual knowledge; the second involves knowing *how* to do something and concerns procedural knowledge.

Organizational psychologists know that there is a right way and a wrong way to choose people who can perform well in specific jobs. Moreover, there is no difference, in principle, between the method for choosing good CEOs and the method for choosing good janitors—although the consequences of choosing a bad CEO are much more severe than the consequences of choosing a bad janitor. However, tested knowledge and proven methods for making good selection decisions are all but ignored when it comes to how CEOs are hired.

A friend of ours, an expert in employee selection, consulted with a franchise in the National Basketball Association. To his dismay they hired player after player based on technical ability, and each of these players was subsequently released—at great cost—for reasons of bad conduct. We asked our friend why the franchise owners ignored his hiring advice, and he said, "There is so much money and ego involved in these decisions that no one cares what I think." Much the same sentiment seems to apply in the process of selecting CEOs. CCL's research on executive selection confirms that little rigor is used when appointing top leaders.

Editor's note: Issues & Observations is a venue for CCL staff members and associates to express their personal views about leadership.

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CEO selection is prone to three recurring problems.

First, CEOs are invariably chosen by boards of directors, and board politics are a major factor driving the hiring decision. Jeffrey Sonnenfeld, founder of the Chief Executive Leadership Institute at the Yale School of Management, once observed that when boards choose CEOs, the process resembles a junior high school class election.

Second, CEOs are usually chosen based on their demonstrated technical abilities. They are invariably very good at some aspect of business—they have a well-honed specialty of some sort that creates an aura of expertise. But they are rarely chosen on the basis of a demonstrated talent for leadership. This is consistent with the widespread popular belief that leadership is a function of circumstances, that if people are in charge of something, they are by definition leaders.

Finally, CEOs are often chosen based on their perceived ability to handle a single, narrowly defined issue. In the case of Hewlett-Packard, for example, one powerful member of the board wanted a new CEO who could consummate a merger with Compaq. So HP brought in Carly Fiorina. She was hired for the express purpose of buying Compaq, and no consideration was given to her prior performance as a leader. This proved to be a big mistake.

RAPID RISE

The case of Stanley O'Neal, former CEO and chairman of Merrill Lynch and a former board member of General Motors, exemplifies several important themes in CEO selection, performance, and leadership.

O'Neal was born in rural Alabama to a farming family. As a teenager, he started work on a General Motors assembly line in Atlanta, where he was identified as having high potential. GM sent him on scholarship to the General Motors Institute and then Harvard Business School, where he completed an M.B.A. degree in 1978. He returned to GM as an analyst, and three years later was a director in the treasury division. He joined Merrill Lynch in 1986 and advanced quickly, running the leveraged finance division in the early 1990s. After serving as global head of capital markets and co-head of the corporate and institutional client group, jobs in which he gained a reputation for hard-nosed analytical skill, he served as CFO from 1998 to 2000. This remarkably rapid rise suggests that O'Neal is smart, ambitious, and talented at organizational advancement, but says nothing about his leadership ability.

Meanwhile, the CEO of Merrill Lynch, David Komansky, who was widely popular among the company's employees, began losing favor with the board, in part because other competitors seemed to be growing more rapidly and in part because he developed a reputation for a loose and perhaps too collegial management style. Merrill Lynch was known to accept lower profit margins in order to pay and retain veteran employees. Industry watchers believe that the board forced Komansky to appoint O'Neal as president and heir apparent in 2001. In 2002, Komansky retired, and O'Neal became CEO and chairman—the first African American to run a major Wall Street firm. He pushed his staff to match industry leader Goldman Sachs and began buying mortgages to package into securities. Experts say O'Neal did not understand risk management, and further note that neither the Merrill Lynch board nor the executive team included anyone with deep knowledge of subprime mortgages who could properly evaluate the soundness of these substantial bets. At the same time, Goldman Sachs and JPMorgan Chase were reducing their investments in the mortgage securities business.

O'Neal's mandate from the board was to shake things up, which in part would require overhauling Merrill Lynch's legendary supportive culture, referred to as "Mother Merrill." O'Neal moved quickly, cutting 25,000 employees (a third of the total workforce) and nineteen top executives, most of whom were his potential rivals. He did this, according to National Public Radio, with "ruthless efficiency." He aroused substantial resentment by firing popular managers who had been friendly with Komansky, and he tried to change the culture from one of collegiality to one of pure competition.

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O'Neal initially delivered strong financial results, and Merrill Lynch quickly became the most profitable investment bank in the United States. This, in turn, allowed O'Neal, essentially, to choose his own board; he handpicked nine of the eleven directors, and several of these nine were close friends and former associates of his from GM. O'Neal managed to further escape oversight when Jill K. Conway resigned as the lead independent director on Merrill Lynch's board in May 2007 and was never replaced. Although a lead director is not required by law, not having one is a "major governance gap," according to Sonnenfeld.

Things fell apart quickly when the bottom dropped out of the subprime mortgage market; Merrill Lynch was forced to write down more than $8 billion, the largest loss in the history of the firm. Then it was reported that O'Neal had approached another bank, Wachovia, about bailing him out by merging with Merrill Lynch, and that he had done so without consulting his board. This cost him the support of the board—NPR called the board reaction a "corporate mutiny"—and he was asked to resign, but he left with a total compensation package of $200 million.

WRONG REASONS

What lessons can be learned from O'Neal's swift ascent and subsequent derailment? From our perspective the lessons are neither new nor surprising; in fact they are quite predictable. O'Neal's derailment can be traced to three sets of distinct factors.

First, he was hired by the Merrill Lynch board to deal with a single issue—cutting costs and tightening management practices—*with no consideration of his track record as a leader.* CCL's research on executive selection indicates that top leaders are typically brought in to address one or two burning organizational needs. In other words, long-term success is sacrificed for the sake of short-term fixes and performance touch-ups.

Second, O'Neal was hired by the board based on his technical skill as an analyst and cost cutter, as a "numbers guy"—again, *with no consideration of his track record as a leader.* This is also consistent with CCL's research on executive selection. In CCL's studies the single most commonly identified strength among newly appointed senior executives was *technical expertise.* Furthermore, whereas *specific functional background* was identified as a key candidate requirement in nearly two-thirds of executive selection decisions, *leadership skill* was identified as a candidate requirement in less than one out of three cases.

Third, there is the issue of O'Neal's personality. The reason his personality was a problem requires a bit of additional commentary. Our approach to these issues depends on three major assumptions, all well supported by research.

The first assumption is that leadership matters; beyond luck, leadership is the key to organizational success or failure. This assumption may seem obvious, but it is not necessarily shared by many business school faculties or the boards of major corporations.

The second assumption is that personality drives leadership style—that who you are determines how you lead. Some people have more talent for leadership than others, and if you are one of those people who lacks talent for leadership, then you should take steps to remedy the problem or risk failure.

The third assumption is that the fundamental tasks of leadership involve building and maintaining a high-performing team, developing a constituency that supports the efforts of the team, and guiding the team to victory.

PERSONALITY WOES

Research shows that managers typically fail for eleven reasonably well-defined personality-based reasons, all of which are associated with an inability to build a team.

Fiorina, for example, displayed an arrogance that resulted in her alienating her staff, ignoring feedback, and blaming failing corporate results on subordinates. O'Neal fell victim to a syndrome that involves toughness, insensitivity to staff morale, and a tendency to use silence as a weapon and to be a loner who avoids communication.

O'Neal has been described in the business press as private, uncommunicative, aloof, steely, unflinching, and brusque. These tendencies led to a number of specific behaviors with negative implications for leadership.

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For example, Merrill Lynch insiders report that O'Neal personally fired many of his top executives and used the occasion to humiliate them, a process that created enormous anger, fear, and resentment among those who remained with the organization. In addition, O'Neal surrounded himself with like-minded people, discouraged dissent, and suppressed constructive dialogue and debate during strategy sessions.

Moreover, one important task of leadership is to manage conflict within the team; in contrast, O'Neal ignored and possibly encouraged conflict among his subordinates by pitting them against one another. The negative impact of his behavior on subordinates is reflected in the fact that they began leaving in droves well in advance of the markdown fiasco.

Finally, O'Neal preferred to keep to himself and had great disdain for *schmoozing*. In the end his relations with the board members—many of them former friends and associates—became strained.

As a result of the way O'Neal treated people, when the organization's performance and numbers plummeted, he was left with no support. It is amazing how much outrageous, rude, and abusive behavior people will tolerate from bosses as long as those bosses deliver good results. But when results turn south, tolerance goes away. More generally, however, the O'Neal saga is one more illustration of the problems that occur when people are chosen for leadership positions in the absence of evidence that they have any talent for leadership.

UNUSED RESOURCE

Interestingly, personality is a powerful predictor of one's interpersonal and leadership style. Further, personality is quite easy to reliably and accurately assess with well-developed psychological assessment tools. Personality tests are widely used, with great success, in making a range of selection decisions, from customer service employees to salespeople to police officers and, yes, even janitors.

CCL's research on selection, however, indicates that personality assessments are rarely used to hire senior executives. Evidently, decisions makers assume that people skills and interpersonal style are more important for custodial staff than for senior leadership—an assumption that most people would recognize as foolhardy.

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