Abstract

To date, Founder-CEOs received very little attention in the field of Strategic Management. This holds for the role of founder-CEOs regarding the company's long-term performance and competitive advantages, as well as for differences in decision-making behavior when compared with salaried CEOs. Founders and family members usually have larger shares in the company and, due to their participation when building up the company, generally a more requisite knowledge, stronger voice and decision-making power. Their long and personal affiliation to the company also effectuates a more intrinsic motivation and a more emotional attachment compared to salaried CEOs. In this paper, we analyze whether founder-CEOs are less susceptible to myopic behavior than salaried managers.

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Introduction

Even if the number of articles about founder-CEOs – founders who still lead their company – increased in recent years (Certo et al., 2001; Fahlenbrach, 2004, Fahlenbrach, 2009; He, 2008; Jain & Tabak, 2008; Jayaraman et al., 2000; Palia et al., 2008; Wasserman 2003), the role of founder-CEOs has still received little attention in the field of Strategic Management. This holds for the role of founder-CEOs regarding the company's long-term performance and competitive advantages, as well as for differences in decision-making behavior compared to salaried CEOs. Since most studies identified a better financial performance of firms led by founder-CEOs compared to firms lead by salaried CEOs, it is apparent that founder-CEOs have a positive role in organisational success (Fahlenbrach, 2009; Johnson et al., 1985; Morck et al., 1988; Slovin & Sushka, 1993). In contrast, there is support that founder-CEO firms are being undervalued by the financial market. Johnson et al. (1985) conducted an event study of sudden executive deaths and came to the conclusion that, on the one hand, founder-CEO firms perform better, on the other hand, deaths of founder-CEOs affect stock prices in a positive way while regular CEO deaths cause decreases of stock prices.

Studies came to different conclusions regarding the reasons of performance differences and potential undervaluation (Ederington & Salas, 2005; Fahlenbrach, 2009). Zahra and Filatotchev (2004) argue that founders have other interests than regular shareholders and try to enforce themselves by entrenchment tactics and opportunistic behavior (Zahra & Filatotchev, 2004: 895). However, Fahlenbrach (2004: 4) discovers that founder-CEOs do not use information asymmetries for their own advantage – in contrast to salaried CEOs. He examines how founder-CEOs behave before and after their companies perform worse. As a result founder-CEOs tend to stay in their company and retain their stock. In addition, founder-CEOs generally do not leave their company before they retire. Finally, founder-led firms are less likely to be candidates for takeovers (Fahlenbrach, 2009: 439). It is believed that the positive influence of founder-CEOs can be attributed to an absence of 'managerial myopia', which is considered in this study.

Theoretical Background and State of Research

'Managerial myopia' can be understood as the preference of managers to choose projects with immediate revenues over long-term oriented projects and strategies which will generate future earnings (Mizik, 2010: 594; Porter, 1992: 3). Various studies show the existence of myopia in the decision-making behavior of managers (Berger et al., 1997; Bushee, 1998; Cheng et al., 2007; Chowdhury, 2011; Chowdhury & Fink, 2012; Florackis & Ozkan, 2009;

Graham et al., 2005; Hayes & Abernathy, 1980; Miller, 2002; Nagarajan et al., 1995; Rappaport, 1978). A financial consequence of myopic management – in particular, the reduction of R&D and marketing expenses in order to meet short-term goals – is the decrease of company value and a deterioration of the position of long-term oriented shareholders (Mizik, 2010: 594). Myopic actions thus can have a greater negative impact on the future financial performance of a company than manipulation of balance sheet items. Nagarajan et al. (1995: 578) examine the tendency of managers of U.S. companies to preferably invest in short-term projects with low risk instead of pursuing value-maximizing long-term strategies. They further show that managers come to their project decision, either to improve the perception of their own abilities in the labor market or to diminish the probability of being replaced. Hence, managers 'entrench' themselves when choosing short-term projects and aim to build their reputation by investing in long-term projects.

So far, myopic behavior and possible counter-measures have been mainly discussed in the context of agency theory (e.g. Holden & Lundstrum, 2009; Lundstrum, 2002; Mizik, 2010; Nagarajan et al., 1995). Such neo-institutional perspectives on myopic behavior and associated risks refer to Berle and Means' (1932) observation of separation of ownership and control. According to agency theorists, an increasing dispersion of shareholders, the anonymity of stock markets, and the size of companies foster a growing gap between owners and managers (Berle & Means, 1932; Jensen & Meckling, 1976). Agency theory suggests a model where agents (managers) act on the behalf of their principals (owners). However, due to information asymmetry, agents may be motivated to pursue self-interests – disregarding what is best for the company and instead favoring their own interests at the expense of shareholder wealth maximization (Coase, 1937; Fama, 1980; Fama & Jensen, 1983; Jensen & Meckling, 1976). To prevent such opportunistic behavior, agency theorists proposed a wide range of corporate governance mechanisms such as reward systems (Eisenhardt, 1985).

Ironically, the same corporate governance mechanisms which aim to align shareholders' and managers' interests create capital market pressure which can again foster managerial myopia. For example, these mechanisms increase the influence of institutional investors who may only pursue short-term financial goals (Bushee, 1998). Quarterly earnings reporting has a similar myopic-inducing effect (Graham et al., 2005). Graham et al. (2005) find that managers tend to avoid starting positive NPV projects or spending in R&D and other long-term oriented investments if they do not achieve the anticipated quarterly earnings otherwise. Accordingly, managers are disposed to give up company value, competitiveness and, ultimately, employees' interests to meet short-term earnings goals instead.

Laverty (1996: 826) stresses that managerial and organizational issues should be considered more comprehensively in the context of short-termism in lieu of an exclusive focus on economic dimensions. We also argue that it is critical to go beyond agency theory and not only to analyze the share of ownership and corporate governance systems but also to discuss the social context of owners and to incorporate insights from behavioral perspectives (Chrisman & Patel, 2012; Cyert & March, 1963; Miller et al., 2011; Pepper & Gore, 2012). This is especially true if a company's share is represented by the founder of the company.

According to Chrisman and Patel (2012: 981), companies use aspirations – the comparisons of performance – as feedback mechanisms. If company performance does not meet such aspiration levels, companies tend to engage in tactical and strategic changes instead (see also Cyert & March, 1963). Agency theorists assume that individuals with controlling interests have even greater power to enforce personal benefits than salaried managers when ownership percentage is high, as it is the case in family-led companies (Morck et al., 1988). Behavioral theory (Cyert & March, 1963) and agency theory (Jensen & Meckling, 1976) emphasize that additional stakeholder groups like families increase goal heterogeneity which helps to understand the conflicting implications of behavioral agency theory (Chrisman & Patel, 2012: 979). Hence, loss aversion in family firms causes risk-averse behavior, but myopic loss aversion leads to long-term-oriented decision-making and greater risk taking – both valid due to different intentions and contexts. Chrisman & Patel (2012: 992) come to the conclusion that family firms on average are more risk averse than non-family firms. On the other hand, managers and family owners who are more attached to long-term family goals are rather willing to make risky long-term investment decisions. Referring to the myopic loss aversion framework of Chrisman and Patel (2012), the occurrence of long-term orientation of family firms (Le Breton-Miller & Miller, 2006) depends on visions of family owners regarding the alignment of family and economic goals.

Besides, there is reason to believe that family-owned and founder-managed companies are less susceptible to myopic behavior. Founders and family members usually have larger shares in the company and, due to their participation when building up the company, generally a more requisite knowledge, stronger voice and decision-making power (Fahlenbrach, 2009; Souder et al., 2012). Their long and personal affiliation to the company also effectuates a more intrinsic motivation and a more emotional attachment when compared with salaried CEOs (Wasserman, 2003). 'Founder-CEOs often consider their firm as their life's achievement' (Fahlenbrach, 2009: 440) and tend to act less opportunistically. According to Fahlenbrach (2004: 4), founder-CEOs who have information advantages stay in their company and keep their stock, even if they expect a deterioration of the company's profitability or industry performance. Agency theorists argue that managers tend to disregard information advantages and selfish interests when they have higher ownership percentage and choose value maximizing strategies instead (Eisenhardt, 1985; Fama, 1980; Jensen & Meckling, 1976).

However, the extent to which founders are less influenced by the expectations of markets and financial analysts and, to that effect, less prone to myopic behavior has not been considered in the literature. Fahlenbrach (2009) arrives at significant results regarding the investment behavior of founder-CEOs who invest more in R&D, have higher capital expenditures associated with positive NPV projects and conduct more focused mergers and acquisitions. There is a lack of explanations for such differences in behavior. Several studies suggest a better financial performance and higher market valuations of founder-led companies (e.g. Fahlenbrach, 2009; Johnson et al., 1985). Nevertheless, studies come to different conclusions regarding the importance of the CEO for the performance of a company (Ederington & Salas, 2005; Fahlenbrach, 2009; Zahra & Filatotchev, 2004). As well, there is still a lack of explanation for the often higher valuations of founder-led companies by the market.

Research Project

In this paper, we analyze whether founder-CEOs are less susceptible to myopic behavior than salaried managers. In order to measure managerial myopia we specifically examine cuts in R&D spending and strategic downsizing made when a company's performance falls below its own 'aspiration levels' (Chrisman & Patel, 2012; Cyert & March, 1963). Prior research provides evidence that reductions of R&D expenditures are used to meet short-term earnings goals (Bushee, 1998; Dechow & Sloan, 1991; Mizik, 2010). Another method to measure myopia is strategic downsizing, often in the form of excessive layoffs or other cost-cutting measures taken at the expense of future earnings, fundamentally disregarding soci(et)al (Berglund & Wigren, 2012) interests. We use the sample of Standard & Poor's 1500 which covers approximately 90% of the U.S. market capitalization, and focus our analysis over a longitudinal period of 20 years. We take earnings-per-share-of-last-year to be the aspiration level of top management and compare consecutive years within the period of interest.

Implications for Research and Practice

The results indicate several further implications for research and practice. We shed light on the role of founder-CEOs in agency relationships and correspondent environment which was not yet considered. Our research findings further help to explain the decrease of agency problems with rising ownership percentage and give information on the extent to which separation of ownership and control makes sense in terms of financial performance measures. Particularly, the results contribute to the theory of managerial myopia and explain how myopic behavior increases with the number of owners, as well as how it differentiates regarding founder status. Therefore, useful parameters are identified to measure myopic behavior. Implications of the role of CEO ownership percentage for the performance, as well as, the competitiveness and long-term benefits of a company are obtained. Market participants (e.g. analysts, companies, small investors and institutional investors) could anticipate the assumed behavioral differences between founder-CEOs and salaried CEOs to align governance and investment strategies. Implications can also be derived from market reactions, for instance whether and how founder-CEOs are systematically underestimated and which signaling effects they have compared to salaried CEOs. Due to the longer period of analysis, conclusions regarding trends on the behavior of founder-CEOs can be drawn that are linked to specific events. This will further help to develop appropriate prevention measures and corporate governance mechanisms to face myopic behavior.

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