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The influence of CEO power on explorative and exploitative organizational innovation☆,☆☆

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A B S T R A C T

Despite the growing research evidence on the effect of powerful CEOs on organizational outcomes, their role in shaping the firm's innovation agenda has received little scholarly attention. This study examines the effect of CEO power on exploratory and exploitative innovation. Drawing from core arguments of Behavioral Agency Theory, this study proposes that firms led by powerful CEOs are likely to pursue more exploratory and less exploitative innovations. Furthermore, these relationships are significantly strengthened by CEO Outsider Status. Using data from 150 U.S. firms, the results reveal a significant positive relationship between CEO power and explorative innovation. Contrary to predictions, firms led by powerful CEOs engage in more not less exploitative innovation when the CEO is appointed from outside the firm. Overall, the findings provide a more nuanced explanation of the link between CEO power and organizational innovation. Implications for research and practice are discussed.
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1. Introduction

Do powerful CEOs influence corporate strategies and organizational performance? If so, in what ways? Are powerful CEOs attracted to risky and novel corporate strategies? Alternatively, do they instead prefer more measured and conservative actions? These questions continue to attract both scholarly and practitioner attention. The popular business press is ripe with discussions on powerful CEOs and their daring corporate actions (Helft, 2014). Corporate governance researchers have examined this issue under the broader "executive effects" literature using the upper echelons research tradition (Crossland, Zyung, Hiller, & Hambrick, 2014). More specifically, scholarly discussion on this topic has empirically examined the link between CEO power and organizational performance (Adams, Almeida, & Ferreira, 2005; Lee, Park, & Park, 2015; Tang, Crossan, & Rowe, 2011). Recent studies have also identified a significant relationship between CEO power and the choice of various corporate strategies such as mergers and acquisitions (Brown & Sarma, 2007; Chikh & Filbien, 2011). So far, growing empirical evidence of the influence of CEO power on both the choice of corporate strategies and organizational performance exists (Tang et al., 2011).

Despite the mounting evidence on the effect of powerful CEOs on organizational decision-making and performance, their role in shaping the firm's innovation agenda is less clear. While current scholarly work has shown a significant link between powerful CEOs and the choice of certain corporate strategies, neither the corporate governance nor the organizational innovation literatures specifically outline whether and how powerful CEOs influence organizational innovation activities. Exploring the role of CEO power on organizational innovation is important for several reasons: first, CEOs hold a prominent structural position in the upper echelons and play a critical role in shaping strategic decisions (Crossland et al., 2014). Second, while other top management team members and board of directors are also involved in strategic decision-making, CEOs are expected to maintain an active and aggressive role in strategy formulation. CEOs are often expected by key stakeholders to be the principal architects of the firm's innovation agenda (Berger, Dutta, Raffel, & Samuels, 2016). The purpose of this study is to explore the link between CEO power and the choice of organizational innovation strategies. Specifically, the relationship between CEO power and two types of organizational innovation strategies (exploratory and exploitative innovation) is empirically investigated (Mueller, Rosenbusch, & Bausch, 2013). Drawing from core arguments of Behavioral Agency Theory (Wiseman & Gomez-Mejia, 1998; Pepper

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& Gore, 2015), the differential impacts of powerful CEOs on organizational innovation activity is developed and empirically tested to extend the theory's key tenets to innovation research with an emphasis on risk-taking tendencies that surround innovation strategies. The current research proposes that firms led by powerful CEOs are more likely to pursue exploratory as opposed to exploitative innovations. Furthermore, this study argues that the link between CEO power and organizational innovation strategies is significantly strengthened when the CEO was recruited from outsider of the firm.

This study makes a number of contributions to the on-going scholarly research on the role of strategic leadership and firm innovation. First, this study improves scholarly understanding of the role these key leaders play in shaping the firm's innovation agenda. Surprisingly, relatively little is known on how powerful CEOs impact organizational innovation (Berger et al., 2016). Second, this study contributes to research on strategic leadership and executive succession by highlighting the important role of CEO outsider/insider status in shaping the choice of organizational innovation strategies. Specifically, drawing from insights from behavioral agency theory and strategic leadership literature, the current study explores how the risk-taking tendencies of outsider CEOs might influence the choice of organizational innovation strategies. In doing so, this research extends the current work in corporate governance (Karaevli, 2007) and human capital transfer (Hamori & Koyuncu, 2015) literatures by exploring the implications of executive succession on organizational innovation. Additionally, this work provides practical insights on how the executive succession and selection process might be considered in developing the firm's innovation agenda. In the following section, the major findings on CEO power and organizational outcomes as well as executive determinants of organizational innovation are reviewed.

2. Theory and hypothesis development

2.1. Executive predictors of organizational innovation

Innovation is pertinent to firms as a strategic tool used to strengthen their competitive position (Crossan & Apaydin, 2010). This study adopts Damanpour (1991)'s definition of innovation as: “innovation is a means of changing an organization, whether as a response to changes in its internal or external environment or as a preemptive action taken to influence an environment” (p. 556). Consistent with previous studies (e.g. He & Wong, 2004; Jansen, Van Den Bosch, & Volberda, 2006), innovation is classified as either explorative or exploitative.[1] This classification addresses whether the innovation speaks to the needs of existing customers (i.e. exploitative) or whether the innovation is designed for completely new target markets (i.e. explorative) (Benner & Tushman, 2003). Products that require a departure from existing products or activities are those that result from new knowledge and hence considered explorative (March, 1991; Levinthal & March, 1993). Exploratory activities are captured by “terms such as search, variation, risk taking, experimentation, play, flexibility, discovery, and innovation” (March, 1991, p. 71). In contrast, products that meet the needs of existing customers and result from present knowledge are exploitative by nature (March, 1991; Levinthal & March, 1993). Exploitative activities are captured by “terms such as refinement, choice, production, efficiency, selection, implementation, and execution” (March, 1991, p. 71). These two activities draw upon unique resources and processes thereby producing different outputs that in turn, differentially impact firm performance (O'Reilly & Tushman, 2013).

Because of the differences in expected outcomes, research argues that exploration and exploitation do not carry the same levels of risk and consequently, require different investments (He & Wong, 2004). Considering the *ex-ante* risk of each type of innovation allows for better assessment of the risk threshold executives perceive as allowable in their strategic decisions given their level of power. That said, explorative innovations are characterized as riskier than exploitative innovations due to their outcome's uncertainty. Consistent with the innovation and organizational learning literature, firms that engage in *both* exploration and exploitation are more likely to ensure optimal firm performance[2] (O'Reilly & Tushman, 2013). Firms that solely focus on either exploration or exploitation risk not being able to adapt to environmental changes (O'Reilly & Tushman, 2013). As such, a firm's long-term survival depends on its ability to “engage in enough exploitation to ensure the organization's current viability and to engage in enough exploration to ensure future viability” (Levinthal & March, 1993, p. 105). However, powerful executives tend to disproportionately focus organizational effort on specific strategies they believe will provide the greatest chance for creating a sustainable competitive advantage and high performance (Jansen et al., 2006). Research supports the notion that executives significantly influence strategic decisions and by extension, organizational outcomes (Tang, Li, & Yang, 2015). Furthermore, research also shows that individual differences may bear *more* influence on approaches to innovation than do other predictors such as organizational and environmental factors (Damanpour & Schneider, 2006). Such studies look at executives' demographic characteristics as well as attitudes toward innovation (Damanpour & Schneider, 2006; Abebe & Angriawan, 2014).

2.2. CEO power and organizational outcomes

Executives have been shown to directly shape various organizational outcomes in important ways (Finkelstein, Hambrick, & Cannella, 2009). Variations in firm outcomes are the direct result of the strategic choices made by executives with varying career experiences, trainings and networks (Finkelstein et al., 2009). Among top executives, the CEO occupies a position of unique influence over firm processes and outcomes, which in turn dictate the firm's likelihood for success (Combs, Ketchen, Perryman, & Donahue, 2007). CEOs have a great deal of discretion in their strategic choices and subsequent decision-making because of their power. Power, here, is defined as the “capacity of individual actors to exert their will” (Finkelstein, 1992, p. 506) as a means of pursing his/her goals. Finkelstein (1992) proposed four dimensions of CEO power: structural, ownership, expert, and prestige power. Structural power pertains to the positional influence relating to the formal organizational structure of the firm. Ownership power accumulates to CEOs who maintain ownership within the firm and is further indicated by the individual's ability to act on behalf of both management and shareholders alike (Ting, 2013). Expert power accrues to CEOs who are able to effectively manage the firm's uncertainty in the external environment through their experience and relevant expertise (Hamori & Koyuncu, 2015). Lastly, prestige power stems from the CEO's reputation within the market that shapes the perceptions others hold of him/her. CEO power is exercised across a wide range of strategic decisions that differentially impact organizational outcomes (Adams et al., 2005). In the next section, the role of CEO power in shaping the firm's innovation agenda is discussed.

[1] The term innovation has been conceptualized in various ways including the classic Schumpeterian view of innovation as creative destruction (Schumpeter, 1934) as well as recent conceptualizations as incremental vs. radical, process vs. product (Damanpour, 1991; Crossan & Apaydin, 2010). However, the current conceptualization of innovation as exploratory and exploitative innovation has also been extensively employed in the innovation and corporate governance literatures. This approach was chosen to help address the specific research questions.

[2] While significant scholarly work points to the strategic benefit of ambidexterity, an extensive empirical work has also shown that firms don't always seek ambidexterity and that some firms under-or over-emphasize exploitation or exploration innovation depending on the organizational attributes and the level of uncertainty and technological complexity of their competitive environment (Junni, Sarala, Taras, & Tarba, 2013; O'Reilly & Tushman, 2013). The contingency conditions for ambidexterity are not explored given the scope of the present research.

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