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The impact of CEO successor origin on corporate divestiture scale and scope change

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ABSTRACT

The effect of CEO successor origin on strategic change in organizations has been inconclusive. While the conventional view suggests that more changes are likely to occur in firms led by new outside CEOs, recent evidence shows that outside successors often face challenges in affecting changes due to their lack of firm-specific knowledge. Our paper examines how CEO successor origin leads to variations in firms' strategic orientations during portfolio restructuring. Through investigating two dimensions of strategic change in restructuring, we demonstrate that new inside CEOs are associated with a greater scale of divestiture, whereas new outside CEOs are associated with a greater scope change through divestiture. Our results, based on 234 divestiture programs in the United States between 1986 and 2009 demonstrate that both new inside and outside CEOs can affect the changes in restructuring firms, albeit in different ways, depending on the scale and scope change following a divestiture program.

Chief executive officer (CEO) succession helps overcome organizational inertia (Tushman & Romanelli, 1985) and leads to organizational change (Wiersema & Bantel, 1993). However, research on the impact of CEO successor origin on organizational change has been inconclusive and lacks cumulative evidence (Giambatista, Rowe, & Riaz, 2005; Kesner & Sebora, 1994; Zajac, 1990). Considerable research shows that inside and outside CEO successors have distinguishable effects on a company (Helmich, 1975; Helmich & Brown, 1972; Pitcher, Chreim, & Kisfalvi, 2000; Zhang & Rajagopalan, 2004). However, one critical indeterminacy remains: whether CEOs promoted from within an organization (i.e., insiders) or those recruited externally (i.e., outsiders) can more effectively achieve organizational change. As Zajac (1990, p. 219) notes, "Outsiders can influence the firm because they are not encumbered by existing relationships in the firm, but insiders can influence the firm because they may use existing relationships to get things done."

Past research on executive succession suggests that new outside CEOs can start afresh and have a greater mandate as well as latitude to make changes to organizations (Finkelstein, Hambrick, & Cannella, 2009), while new inside CEOs help ensure continuity in the firm's existing strategy (e.g., Cao, Maruping, & Takeuchi, 2006; Carey, Ogden, & Roland, 2000; Friedman & Singh, 1989; Helmich & Brown, 1972). However, more recent evidence (e.g., Karaevli & Zajac, 2013; Zhang & Rajagopalan, 2010) indicates that although new outside CEOs are often brought in under the expectation that they will help initiate strategic change or turn existing

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firm conditions around, they frequently fail to do so due to their lack of familiarity with the firm's competencies and environment (Shen & Cannella, 2002; Wiersema, 2002). The debate over which types of CEOs (insiders vs. outsiders) lead to greater organizational changes suggests the need for a more nuanced approach.

Much prior research has examined the influence of CEO origin on performance, with the impact on strategic change assumed but not tested (Bommer & Ellstrand, 1996; Davidson, Worrell, & Dutia, 1993; Friedman & Singh, 1989; Helfat & Bailey, 2005; Huson, Malatesta, & Parrino, 2004; Lauterbach, Vu, & Weisberg, 1999). Moreover, it is important to recognize that strategic change is a multidimensional construct. However, research that *has* explicitly studied how CEO origin impacts strategic change has often focused on a unidimensional measure of change, such as change in a firm's diversified scope, likelihood of divestiture, or degree of internationalization (Barron, Chulkov, & Waddell, 2011; Bigley & Wiersema, 2002; Lin & Liu, 2012; Shimizu & Hitt, 2005; Wiersema, 1992). In addition, although some past research on CEO origin effects did use a multidimensional conceptualization of strategic change (e.g., a pattern of changes in resource allocation, firm innovation, top management role changes), it did not study how new inside and outside CEOs may have disparate impacts on different change dimensions (Balsmeier & Buchwald, in press; Helmich & Brown, 1972; Karaevli & Zajac, 2013; Zhang & Rajagopalan, 2004, 2010). We argue that new inside and outside CEO successors possess dissimilar knowledge resources in terms of their experience and knowledge bases within and outside a firm (Barney, 2001; Coff, 2002; Hitt, Bierman, Shimizu, & Kochhar, 2001; Wang & Barney, 2006), which leads to variations in their strategic choices. We focus on new CEOs because although long-tenured CEOs have accumulated firm-specific knowledge resources over time, they may become more risk averse and thus are less willing to make changes (Hambrick & Fukutomi, 1991; Miller, 1991).

Also known as portfolio restructuring, divestitures represent a significant strategic change in a firm's business portfolio through asset sales, spin-offs, leveraged buyouts, and equity carve-outs (Bowman & Singh, 1993; Markides, 1995; Rajagopalan & Spreitzer, 1997). We add value to the succession and restructuring literatures by investigating the differential effects of CEO successor origin on two different aspects of strategic change in the context of corporate divestitures: the scale of divestiture and the scope of divestiture. *Divestiture scale* reflects the total magnitude of a firm's restructuring activities (e.g., how many units to sell), whereas *divestiture scope* reflects a firm's efforts to adjust its product portfolio such as reducing its current level of diversification. In particular, a higher level of divestiture scale does not necessarily lead to a reduced scope of diversification if a firm removes more related than unrelated businesses from its product portfolio. As such, the scale and scope changes in portfolio restructuring, although usually planned concurrently, represent two distinct concepts in a firm's divestment decisions.

We provide two central contributions to the succession literature in this paper. First, examining both dimensions of corporate divestiture provides us with greater insight into how CEO successors (insiders vs. outsiders) might differ in their decisions associated with restructuring and corresponding impact on organizational change. As past research focuses on predicting which types of new CEOs (insiders vs. outsiders) can generate more organizational changes, our study goes beyond the existing research by focusing on *how* and *why* new CEOs exhibit different change behaviors when the situation warrants restructuring.

Second, and relatedly, recent evidence challenging the conventional view that more strategic changes should occur in firms led by new outsiders (e.g., Zhang & Rajagopalan, 2010) suggests the need for a more nuanced approach to the impact of successor origin. Our examination of CEO successors' differential effects on distinct dimensions of restructuring behavior takes the insider/outsider CEO debate beyond a straightforward examination of which type of CEO successor is better able to achieve organizational change, and points to the importance of fit between the type of strategic change required and the new CEO's orientation toward possible change.

Additionally, our study contributes to research on corporate divestitures, which has called for greater attention to managerial differences in order to understand why firms facing very similar conditions make very different divestiture decisions (Brauer, 2006). Specifically, we argue that firm-specific knowledge resources, which relate to the new CEO's firm-specific knowledge and experience, may influence the number and nature of divestitures undertaken. We test our theoretical model on 234 divestiture programs between 1986 and 2009 in the United States and find that both new inside and outside CEOs can impact strategic change in a restructuring firm, albeit in different ways, depending on the scale and scope of the divestiture program. Next, we explain our theoretical model in more detail.

Theory and hypothesis development

Succession and corporate divestiture

Strategic change is “a difference in the form, quality, or state over time in an organization's alignment with its external environment” (Rajagopalan & Spreitzer, 1997, p. 49, p. 49), and has been widely examined in different organizational settings such as variations from a firm's past strategic orientation (Miles & Snow, 1978; Simons, 1994; Zhang & Rajagopalan, 2010) and changes in corporate scope based on the entropy measure of diversification (e.g., Boeker, 1997; Hoskisson & Johnson, 1992; Nakauchi & Wiersema, 2015; Sakano & Lewin, 1999; Wiersema, 1995). Corporate divestiture is a critical form of strategic change in corporate-level strategy that firms often use to either correct previous strategic mistakes by decreasing the firm's scope (Shimizu, 2007) or to proactively change the firm's current portfolio of businesses (Brauer, 2006; Markides, 1992).

Restructuring activities, such as asset divestment, often involve significant changes to a firm and may represent one of the first actions that a new CEO might take (Johnson, 1996). Executive succession is often perceived as a precursor to corporate restructuring (e.g., Berger & Ofek, 1999; Weisbach, 1995; Wiersema, 1992). The management literature has effectively documented that the introduction of a new CEO leads to various types of organizational changes (Fredrickson, Hambrick, & Baumrin, 1988;