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Recent Research

On entrepreneurs, innovation, CEO pay, and executive women.

by Des Dearlove and Stuart Crainer

Born to Run?
Ervin L. Black Sr. (erv_black@byu.edu), F. Greg Burton, Anne M. Traynor, and David A. Wood, "Are Entrepreneurs Born or Made? Views of Entrepreneurs and Venture Capitalists."
http://ssrn.com/abstract=735563

"One does not decide to be an entrepreneur. One is an entrepreneur." So the multimillionaire Internet startup guru Bo Peabody has observed, adding for good measure: "Those who decide to be entrepreneurs are making the first in a long line of bad business decisions."

Others take the opposite view. In 1996, Lloyd Shefsky, a clinical professor of entrepreneurship at Northwestern University's Kellogg School of Management, studied more than 200 entrepreneurs and concluded that the most successful among them were made, not born.

So who is right — or is the answer somewhere in between? This question was tackled by Ervin L. Black Sr. and F. Greg Burton, associate professors of accounting at Brigham Young University; Anne M. Traynor, a student in the entre-

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preneurial program there; and David A. Wood, a doctoral student at Indiana University.

They asked 28 entrepreneurs and 13 venture capitalists (VCs) to identify the salient traits of successful entrepreneurs. The authors then divided the responses into three categories: innate attributes (persistence or risk taking, for example), learnable skills (such as the ability to delegate or to close deals), or experience factors (marketing or networking skills).

The entrepreneurs and VCs couldn't have been farther apart. The characteristics that entrepreneurs most prized were innate attributes: hard work (14.5 percent of respondents named it), persistence (10.8 percent), risk taking (8.4 percent), vision (7.2 percent), and independence (4.8 percent). In fact, entrepreneurs cited inherent traits 62 times out of their 83 responses.

The VCs, on the other hand, emphasized experience. The critical traits for entrepreneurs that they cited most frequently were: industry/domain/market experience (9.3 percent), marketing experience (8.2 percent), passion (7.2 percent), leadership skills (7.2 percent), and startup experience (6.2 percent).

Overall, the researchers found that entrepreneurs believe they are born with 75 percent of the traits necessary for commercial success. But the VCs hold that only 44 percent of the traits necessary for success are inherent in an entrepreneur's nature. As the authors note: "Venture capital providers believe experience is far more important in determining success than entrepreneurs believe."

Avoiding Innovator's Remorse
John T. Gourville
(jgourville@hbs.edu), "The Curse of Innovation: A Theory of Why Innovative New Products Fail in the Marketplace," Harvard Business School Marketing Research Paper no. 05-06.
http://ssrn.com/abstract=777644

Research shows that between 40 and 90 percent of all new products fail to gain market acceptance. In addition, the more innovative a product or service is, the more likely it is to miss. For example, Webvan's online grocery venture, the Segway scooter, and the TV recording technology TiVo have all struggled or failed in the marketplace.

John T. Gourville, an associate professor of marketing at Harvard Business School, offers an explanation for this troubling track record. The more innovative a new product is, the more likely it is to require changes in the behavior and perceptions of consumers who use existing products as their point of reference.

With Webvan, consumers did not have to drive to the store. But in exchange for this convenience, consumers were asked to sacrifice some of the control of the grocery shopping experience, such as the ability to choose their own meat and vegetables. Similarly, in deciding whether to purchase an electric car, consumers often measure it against their current vehicle; electric cars are environmentally friendly, but their driving range leaves a lot to be desired. With most innovations, then, consumers tend to be "loss averse." The disadvantages loom larger in their minds.

Meanwhile, the company introducing the innovative product has a different point of view. Having invested time, money, and energy in developing the product, its managers see its innovative features not as something to weigh but as something to be desired.

This, Professor Gourville notes, has two important implications: "First, it means that consumers will often reject innovations that, objectively, would make them better off. Second, developers will be at a loss to anticipate this rejection. The result will be an increased probability of market failure."

He points to the example of TiVo and DVD players. Both hit the U.S. market in the late 1990s. By early 2005, 80 million DVD players had been sold compared with only 3 million TiVo units, although TiVo spent well over $500 million on marketing. Both products are highly innovative. But whereas the DVD is a direct replacement for the VCR, TiVo requires a huge change in behavior because it completely alters people's television viewing habits.

The author says that the success of an innovation can often be predicted by determining which of four categories it belongs in:

Tinkering: limited technological advance and little change in consumer behavior. For instance, toothbrushes with angled heads. Adoption is likely, but the benefits to both the company and the consumer are limited.

Death: small technological improvement but a major change in consumer behavior. The Dvorak keyboard increases typing speed over the QWERTY keyboard but requires massive retraining. Adoption is very unlikely.

Long haul: significant technological development that requires a significant change in consumer behavior. Think TiVo and satellite radio. Adoption is likely to be gradual. The benefits are potentially large for businesses and consumers, but resistance is also great.

Home run: great technological change that barely alters consumer behavior. When Google debuted on the Web, for example, it was hard to envision the need for a new search engine. Yet by changing the underlying algorithm without altering the user interface, Google attracted people through its superior results. Adoption is a sure thing.

Beware the Glass Cliff

Michelle Ryan
(M.Ryan@exeter.ac.uk) and
Alexander Haslam, "The Glass Cliff: Evidence That Women Are Over-represented in Precarious Leadership Positions," *British Journal of Management,* vol. 16, no. 2.
http://ssrn.com/abstract=734677

In boardrooms around the world, women remain conspicuously underrepresented. In mid-2005, for example, there were just nine women CEOs at Fortune 500 companies — that's less than 2 percent. The failure of women to reach the top has led to concerns about a "glass ceiling": an invisible barrier that prevents women from rising beyond a certain level in many organizations. But, according to new research, there may be another even more insidious obstacle facing executive women.

Michelle Ryan and Alexander Haslam, from the School of Psychology at the University of Exeter in the U.K., argue that when women achieve high-profile corporate positions, frequently the company is in a precarious state. The prestigious jobs that women get, unlike those awarded to men, often fail to live up to their billing.

To test their theory and determine whether the appointment of women to top corporate positions improves or hurts company performance, the authors examined the share prices of FTSE 100 companies in 2003 immediately before and after the naming of a male or female director. In total, 19 women board appointments were made that year. To make adequate gender comparisons, the researchers found 19 companies in the FTSE 100 that had appointed a male director in the same period and, if possible, in the same business sector.

One interesting finding was that the appointment of women to the board tended to smooth out stock prices. Where firms were operating in depressed stock markets, "company performance increased significantly" immediately following such an appointment; appointments made in less unsettled, more sanguine times were followed by stock price stability. When men were named to boards, the results were less pronounced.

Perhaps more significantly, there were marked differences in company performance leading up to the appointment of men and women, especially when stock markets were down. Companies that placed men on the board at such times tended to do so after a period of relatively stable performance. But women's appointments often followed several months of poor performance — with these firms underperforming their sector by about 4 percent.

In other words, women are more likely than men to be placed in leadership positions during difficult times — when stock markets are depressed and performance is poor relative to competitors. "Such women," say the authors, "can be seen to be placed on the top of a 'glass cliff,' in that their appointments are made in problematic organizational circumstances and hence are more precarious."

One explanation is that appointing a woman to the board signals a change in direction. Another, of course, is that such appointments may be poisoned chalices.

A New Take on CEO Pay

Charles A. O'Reilly III (oreilly_charles@gsb.stanford.edu) and Brian G.M. Main (b.g.main@ed.ac.uk), "Setting the CEO's Pay: Economic and Psychological Perspectives," Stanford GSB Research Paper no. 1912. http://ssrn.com/abstract=804584

The classic view of CEO pay — called principal-agent theory — regards executive compensation as a lever that boards and shareholders use to make sure that chief executives deliver results.

The trouble is that the relationship between competitive performance and CEO compensation has been extensively studied, but never conclusively linked. Consequently, Charles A. O'Reilly III, Frank E. Buck Professor of Human Resources Management and Organizational Behavior at Stanford Graduate School of Business, and Brian G.M. Main, director of the David Hume Institute at the University of Edinburgh in the U.K., question the usefulness of principal-agent theory in analysis of CEO compensation.

The authors studied data from an executive compensation firm for 306 semiconductor, manufacturing, and retail companies. The data included firm size; performance; and compensation for the CEO, the board of directors, and executives. Using this information, the researchers concluded that the average CEO compensation package of $1.2 million can be broken down in this way: 54 percent can be attributed to standard economic variables, such as performance, and 46 percent to what they call "influence and interaction," the social and psychological side of power — specifically, the social dynamics of the boardroom.

In particular, the researchers looked at two psychological processes: reciprocity and social influence. Reciprocity is the notion that one good turn deserves another. The authors assessed the weight of this factor by looking at whether the CEO was on the nominating committee; what fees were paid to the head of the compensation committee; and whether, and for how long, the CEO had been on the board before the chair of the compensation committee was appointed.

The research found that the stipend paid to the head of the compensation committee was "strongly related" to the compensation received by the CEO. For every $1,000 that the chairperson of a compensation committee received above the mean stipend for all chairpeople covered by the study, the corresponding CEO's cash compensation was higher by $1,746.

The second process studied was social influence. "Social influence occurs when the group signals, tacitly or explicitly, what attitudes and actions are appropriate and acceptable and what aren't," the authors explained, pointing to the informal power that CEOs routinely exert over their fellow board members. To better understand the power of social influence, the researchers looked at whether the chief executive officer also acted as company chairperson; the number of board committees on which the CEO served; whether the CEO was on the compensation committee; and whether the CEO was older than the chairperson of the compensation committee.

The research found that when CEOs sit on committees (especially at companies that have more committees than average), their influence on the organization is greater and their salaries are around $350,000 higher than those of CEOs who don't typically do committee work.

Among the other interesting findings, two stand out. First, CEO compensation is more closely linked to the size of a firm than to its performance. In fact, company size accounts for 22 percent of the variance in compensation, with performance accounting for a mere 2 percent, according to the authors.

Second, and potentially more controversial, is the finding that CEOs receive more compensation when the board has more women on it. The authors offer three possible explanations: Women are more generous; women directors are more easily manipulated by CEOs; or boards with highly paid CEOs appoint more women. Only the second is dismissed. In the end, the authors argue, board selection must deliberately take into account the combined psychological dynamics of the directors. Only then will CEO incentives be more closely aligned with performance. +