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# The High Price of Bad CEO Behavior

CEO misconduct, be it personal misdeeds, illegal business practices, violations of ethical norms, or something else – seems to be in the news more often these days. And when a CEO misbehaves, the entire company suffers.



The organizational consequences of CEO misconduct are significant. Researchers at Stanford University have shown that when a CEO is caught misbehaving, the stock price of his or her company drops an average of 3.1 percent over the following three days, regardless of the type or severity of misconduct. This drop can result in the loss of billions of dollars in market capitalization. Negative media coverage lasts much longer: References to the CEO's misdeeds often still occur nearly five years after the event. More significantly, one-third of the companies associated with misbehaving CEOs will face follow-on effects from the event, including shareholder lawsuits, proxy battles, a federal investigation, government legal action, or the loss of at least one major client.<sup>1</sup>

Internally, the effect can be equally damaging. Employees who consider themselves ethical may lose confidence in the organization's leadership, and employees who are borderline unethical may feel emboldened to misbehave themselves. The reputational taint may thwart efforts to recruit new employees, and current employees may be more likely to depart the organization to protect their personal and professional reputations.

The good news for boards is that executives whose misbehavior may have gone undetected in the past – or who have the potential to act inappropriately in the future – can often be rooted out during the CEO succession process. By systematically looking for a specific set of behaviors and personality traits in the interview, assessment, and reference phases of the hiring process, companies are more likely to avoid the financial hit, negative media, and reputational stench of impropriety.

<sup>1</sup>David Larcker and Bryan Tayan, "We Studied 38 Incidents of CEO Bad Behavior and Measured Their Consequences," Harvard Business Review, June 9, 2016. <https://hbr.org/2016/06/we-studied-38-incidents-of-ceo-bad-behavior-and-measured-their-consequences>

## DRIVERS OF MISCONDUCT

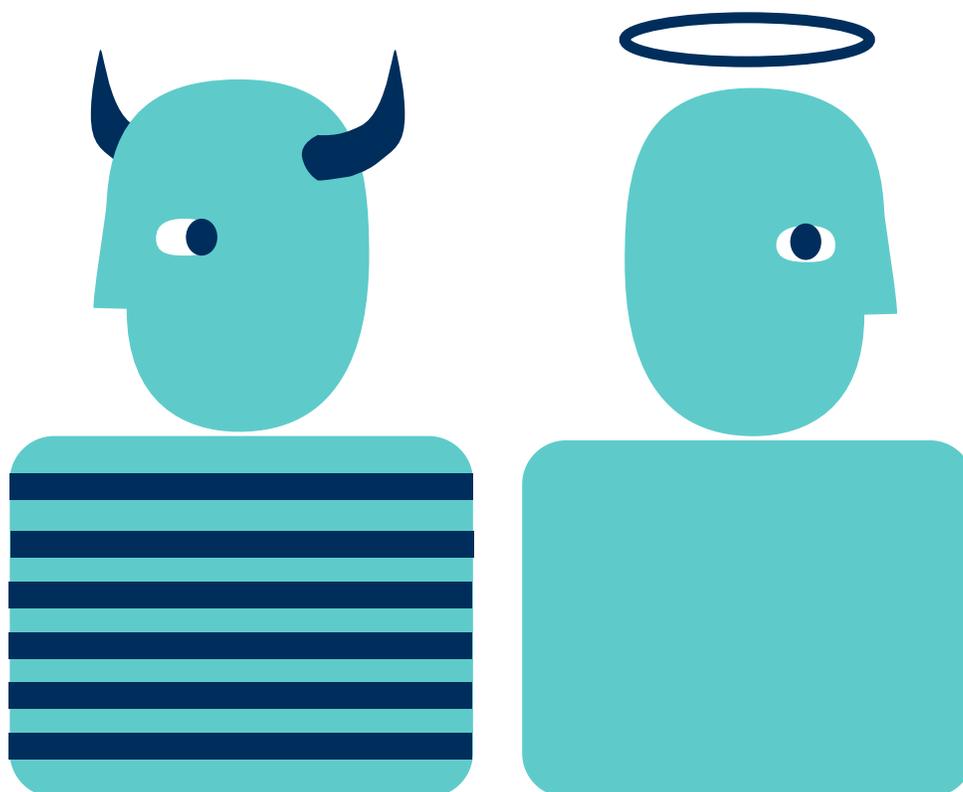
What drives a CEO to misbehave? While there might be proximate causes, including financial or strategic pressure, misbehaving CEOs are fundamentally driven by their natural personality traits – traits that can be assessed, measured, and most importantly, flagged during the hiring process.

These personality traits rose to the surface in a study that assessed 142 inmates at a maximum security prison and compared them to assessments of a general population of executives. Several psychological differences helped define the convicted criminal minds versus those of non-criminal executives: Convicted criminals are more excitable, and more easily frustrated, than the general population. They are more skeptical, and more distrusting. They are reserved, and less transparent. They are more privately rebellious, and more subjective. (One area where felons are lower than the general population? Being dutiful, or compliant and following through.)

When we look at examples of CEOs who have recently been arrested or removed from their positions because of misconduct, these traits are frequently present.

### CONVICTED CRIMINAL PERSONALITY TRAITS

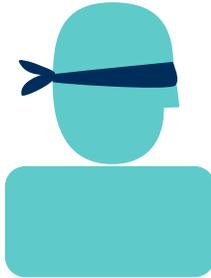
More Excitable  
Easily Frustrated  
Reserved  
Less Transparent  
Privately Rebellious  
More Subjective  
Less Dutiful  
Less Compliant  
Less Likely to  
Follow Through



## FRAMING MISBEHAVIOR

To understand how CEOs misbehave, it is helpful to categorize their misconduct. Recent examples in the news highlight seven forms of CEO misconduct – the majority related to things they do (*misconduct by commission*) but also including failures to act (*misconduct by omission*):

- **Tolerance of, or failure to address, misconduct:** Travis Kalanick, founder and then-CEO of Uber, was forced out of the company after multiple claims surfaced that he tolerated an abusive workplace, including overlooking rampant sexual harassment of female employees.



- **Failure to correct dishonesty:** James Minder, chairman of Smith & Wesson Holding, long kept hidden a criminal past, including serving 15 years in prison for armed robbery. It wasn't until a reporter from the Arizona Republic newspaper contacted him for an explanation that he resigned.



- **Physical or sexually inappropriate activities:** Harvey Weinstein is the most prominent example of physical or sexual abuse in the workplace. To date, more than 80 women have accused the former CEO of The Weinstein Company of everything from inappropriate sexual advances to forceful rape.



- **Substance abuse:** John Skipper, then-CEO of ESPN, battled addiction before finally resigning in 2017. Skipper later admitted that he was being blackmailed over his cocaine use, which he had long kept secret from other executives at the media company.



- **Dishonesty short of fraud:** Multiple CEOs have recently lost their jobs for consensual sexual relationships that were against company policy, and/or not properly disclosed. Among others, Brian Krzanich, the CEO of Intel, Darren Huston of Priceline, Brian Dunn of Best Buy, Kenneth Melani of Highmark, and Stephen MacMillan of Stryker have all resigned or been fired as a result of such activities.



- **Offensive behavior:** This category is often hard to define in advance, but clear in hindsight. John Schnatter, the founder and former CEO of Papa John's, was forced to resign as chairman of the company after it became public that he made multiple racially offensive remarks during internal meetings.



- **Corporate malfeasance or fraud:** Renaud Laplanche, the CEO of Lending Club Corporation, is under investigation by the Department of Justice after the company disclosed that it knowingly sold an investor over \$22 million of loans the investor did not want, then altered loan paperwork.



## IDENTIFYING MISBEHAVERS BEFORE HIRING

Executives who have the potential to misbehave can be identified in multiple ways, and at multiple points, during the hiring process. The personal interview, psychometric assessments, and references form a three-legged stool that enable successful hiring.



### During Their Interview

The interview process is the first point in the hiring process in which an individual's propensity for misconduct will reveal itself. Signs can include being inconsistent in responses to questions or being tough to pin down on details, showing intentional evasion during questioning. Individuals who are likely to misbehave may also be too quick in their comments and responses, demonstrating a lack of interest or willingness to think or reflect before they respond. Other times, they will respond at length when it is their time to speak, but completely fail to answer the question they were asked.

While we expect candidates to put their best faces forward during the hiring process, it is unrealistic to expect them to present histories that are completely devoid of mistakes and failures. Yet executives who are prone to misbehavior are more likely than others to avoid volunteering weaknesses during the interview process. At the same time, they may rationalize any problems that

are mentioned, or make excuses for past behavior, rather than take responsibility for what they have done in the past.

These signs demonstrate a lack of self-awareness, a lack of self-reflection as a normal element of their behavior, or ultimately a failure to monitor and manage one's own behavior.

### Through Psychometric Assessments

The Leadership Span framework for executive assessment identifies two sets of psychometric traits: Loud (Disruptive, Risk Taking, Heroic, and Galvanizing) and quiet (Pragmatic, Reluctant, Vulnerable, and Connecting). Both sets are important for different reasons. The loud traits help push executives forward. But the quiet traits provide the restraint and reflection that stop otherwise hard-charging executives from driving themselves – and their companies – off a cliff.

Research has shown a strong connection between integrity and the presence of quiet traits in a given leader. Yet the quiet traits are often lost in the hiring process, when the company thinks it needs to bring in someone who is hard-charging, confident, self-assured, and willing to take risks, but overlook the need to reign those traits in. A proper psychometric assessment of any candidate should reveal the presence of loud and quiet traits and illuminate how well they balance each other out.

Leadership Span is not alone in measuring such qualities. Assessors can also look at specific measurement scales in tools such as the Hogan Development Survey (HDS) and Hogan Personality Inventory (HPI), including:

- **Bold (HDS):** A high bold score could describe someone who is forceful, arrogant, and demanding.
- **Mischievous (HDS):** A high mischievous score could describe someone who is limit-testing, impulsive, and manipulative.



- **Colorful (HDS):** A high colorful score could describe someone who is seeking attention and trying to be in the spotlight.
- **Imaginative (HDS):** A high imaginative score could describe someone who is unfocused and expansive.
- **Cautious (HDS):** A low cautious score could describe someone who will take reckless risks.
- **Interpersonal Sensitivity (HPI):** A low interpersonal sensitivity score could describe someone who is direct and frank to the point they may treat others poorly.
- **Prudence (HPI):** A low prudence score could describe someone who is flexible, open-minded, and impulsive.
- **Adjustment (HPI):** A low adjustment score could describe someone who is moody and takes problems personally.

### During Referencing

Every hiring process should involve an element of referencing, or contacting individuals who have worked closely with the candidate in the past, and can confirm the information about the candidate along with providing additional perspective. While it's unlikely that a reference will offer up explicit examples of past abuse or misconduct, what they say – and how they say it – will provide substantial insight.

For example, a reference might say that *“John can be quite direct with the people he works with, but he usually apologizes afterwards.”* This tells the interviewer two things – first, the candidate acts this way so often that it is top of mind to people he or she works with, and second, the candidate acts so unprofessionally that he or she recognizes the need to apologize for it afterwards. Interviewers can then probe to find out more about

examples of when such behavior has occurred, how frequent it is and what contexts have provoked it.

Beyond discussions of specific acts, reference calls also create an opportunity to gain insight into the behaviors and mindsets that can contribute to misconduct. Does the candidate listen to others, or does he charge ahead on whatever it is he wants to do? Does she follow only her own beliefs and judgments, or does she consider the broader context and the opinions of others? Reference interviewers will also want to finish the discussion with a broad, open-ended question, such as *“What else haven't we spoken about that would be useful to me in getting to know this individual in terms of their strengths, weaknesses, and areas for development?”*

### BRINGING IT ALL TOGETHER

While each of the three parts can be illuminating on its own, it's the totality of the information collected during the interview, assessment, and referencing that is truly enlightening. Psychometric assessments can confirm the presence of traits that interviews or references hint at, while references can either assuage doubts or fill in missing details around stories that didn't sound quite right in the interview. The totality of the insights can give a hiring manager a complete view of a candidate, and their risk of future misconduct.

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the entire company suffers.  
But when the board acts  
proactively, these problems  
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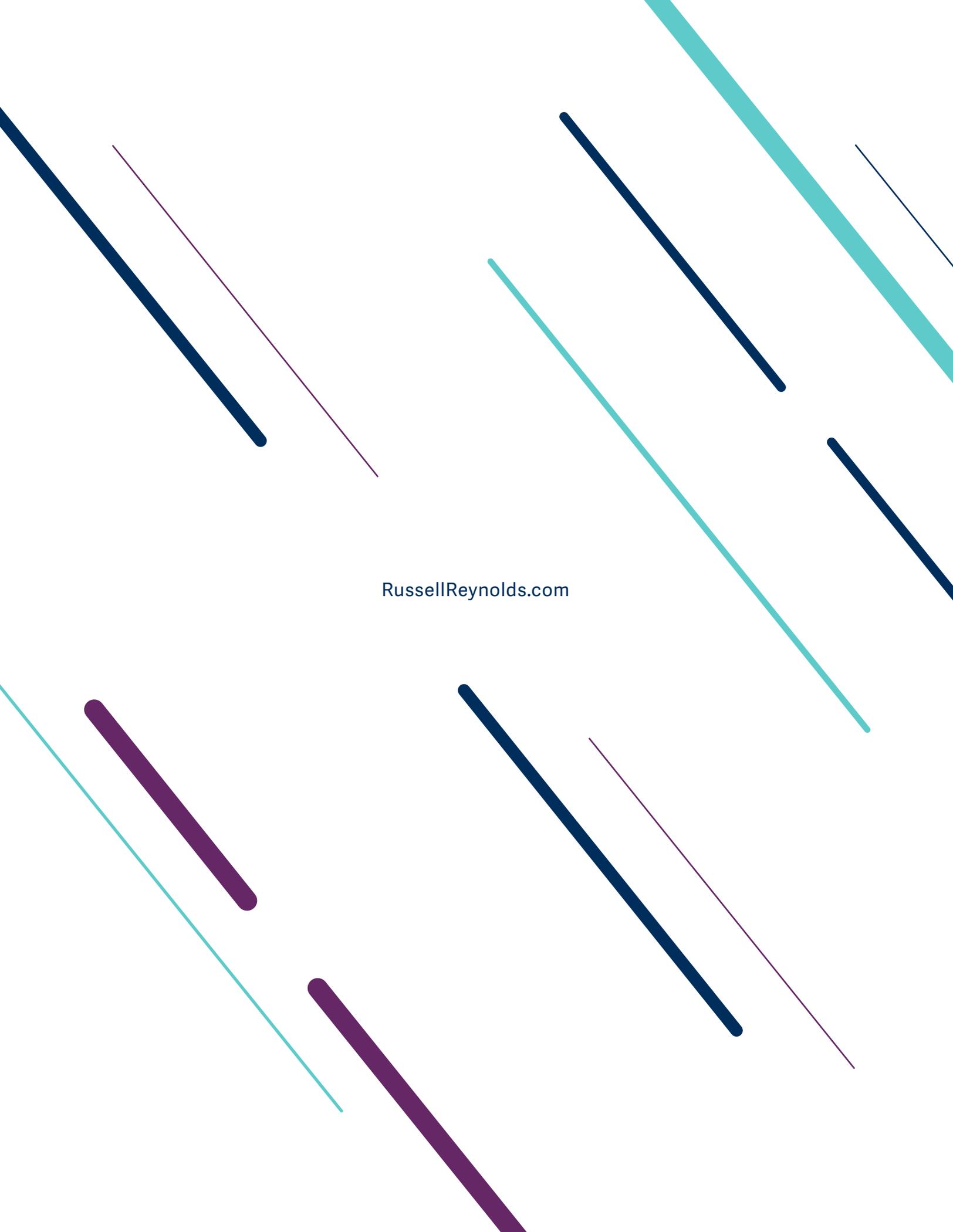
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