KRW RESEARCH INSTITUTE

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WHITE PAPER 102:

The CEO's Worldview and Business Results: A Research Concept Paper

We hope our research will provide the foundation for business schools to significantly impact the moral competency of tomorrow's business leaders.

We believe a new approach to teaching ethics is clearly needed.

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Abstract

This paper rests on the premise that CEOs have a significant impact on the business results of the firms they lead. Measures of business performance, such as return on assets (ROA), reflect either positive or negative results due to a combination of three variables: macroeconomic forces, the business model, and a variable labeled “the CEO effect.” This paper focuses on this last variable—the CEO effect.

We present a breakdown of the five elements that we hypothesize make up the CEO effect: the CEO’s personal history, worldview, decision making, leadership behavior, and the organization’s capacity to execute.

We present a model of the job of the chief executive officer and a model of the execution-ready organization. We hypothesize that the CEO’s worldview determines the manner in which the CEO does his or her job and has a significant and direct impact on investment policy, risk tolerance, organizational strategy, and ultimately, on the corporate culture and the organizational execution readiness level.

We define what we mean by “worldview” and go on to ask several questions that we hope to answer about the expected power of the CEO’s worldview to either create or destroy value, as measured by changes in ROA. We hypothesize that the CEO’s worldview is largely formed by prior experience and operates mostly at a subconscious level while guiding decisions and leadership behavior.

We describe our research design and methodology. And finally, we discuss the implications these research findings could have for business school curricula.

Out of our beliefs are born deeds.

Henry Hancock

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Introduction

This project grew out of the research we did while writing *Moral Intelligence* (Wharton School Publishing, June 2005. Paperback, September 2007) along with co-author, Doug Lennick. Our book received many positive book reviews, and one particular reviewer's comments stayed with us. The US magazine *Newsweek* stated in their June 27, 2005 issue:

> Morality's a hot topic in corporate America, but the authors actually began researching it in the mid-'90s. Their theory: having a leader with high moral intelligence (defined as the capacity to apply principles like integrity, responsibility, compassion and forgiveness to goals and daily actions) is as beneficial for a company's bottom line as it is for the corporate culture. The authors back this up in the 304-page book with anecdotes from dozens of top Fortune 500 executives. But you'll have to wait for the quantitative research. The pair plan to spend several more years compiling data on the relationship between business leaders' moral intelligence and companies' long-term performance.

In short, our book presented a common-sense model with a great deal of support from diverse fields, but it lacked hard financial data showing a bottom-line advantage from leadership grounded by these moral principles.

The KRW Research Institute is nearly three years into an ambitious research project to complete what we believe is the first quantitative research on what CEOs believe and the impact of those beliefs on the bottom line. We are gathering over four hundred separate fields of data on sitting CEOs and their companies. We currently have complete data sets on about sixty-five CEOs from American firms, among them such well-known companies as Costco, Domino's Pizza, REI, Hormel Foods Corporation, Red Hat Software, Metropolitan Airport Commission (MSP), SuperValu, Cray, Inc., and many others. We have just begun to collect data from CEOs in Europe.

We continue to enroll new subjects weekly and plan to have complete data sets on over two hundred American CEOs and a smaller sample of perhaps fifty European CEOs by the end of 2010.

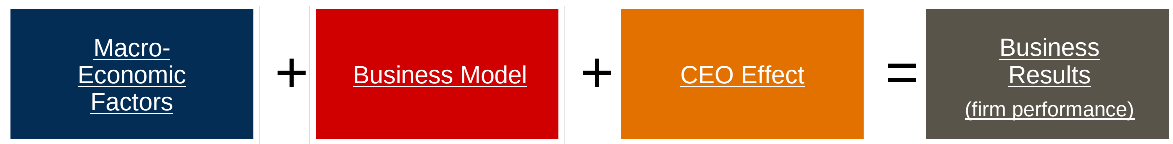
The purpose of this paper is to present a theory for research. It is a theory about the impact CEOs' subconscious beliefs and automatic response patterns have on business results, both positive and negative.

Three Factors that Account for Business Results

There are a host of forces that impinge on any business organization in the course of a year. Some have a great impact on results and others make little difference. We turned to the academic literature in economics and accounting for help in identifying and organizing these many variables. To our pleasant surprise, we discovered that for years, academic researchers in economics and accounting have been examining the many variables that account for a firm's financial performance.[1] These are called "variance decomposition studies," in which the researchers use powerful statistical analyses to sort out what accounts for business performance (often measured by return on assets [ROA] or a proxy such as Tobin's Q[2]) and assign a percentage to each of several different variables.

In the academic literature, these variables are grouped in a number of different ways. We have chosen to categorize them in three areas—macro-economic factors, the business model, and of special interest to us, "the CEO effect." Figure 1 illustrates these three areas. We will briefly describe each one before delving more deeply into the CEO effect.

Figure 1



Macro-Economic Factors

Every CEO lives with the uncertainty of tomorrow. While external forces, such as favorable trade agreements or natural resource advantages, can also be positive, most often macro-economic forces have a negative impact—especially those which occur suddenly. One author[3] calls these unexpected negative events "black swans" and claims that these happen far more frequently than most CEOs expect. A partial list of these macro-economic forces that can destroy positive business results is:

- Sudden industry shifts
- Financial/banking crisis
- Changes in government monetary or fiscal policies
- Currency crisis
- Natural disasters
- War or terrorism attacks
- Oil crisis

[1] For a good overview of this academic research, the reader should consult *Managing with Style: The Effect of Managers on Firm Policies* by Marianne Bertrand and Antoinette Schoar in the *Quarterly Journal of Economics*, November 2003.
[2] Tobin's Q is the market value of equity plus the book value of liabilities, divided by the sum of the book value of equity plus the book value of liabilities—thought also to be a proxy for the firm's growth opportunities.
[3] Nassim Nicholas Taleb, *The Black Swan*: *The Impact of the Highly Improbable*, Random House, 2007.

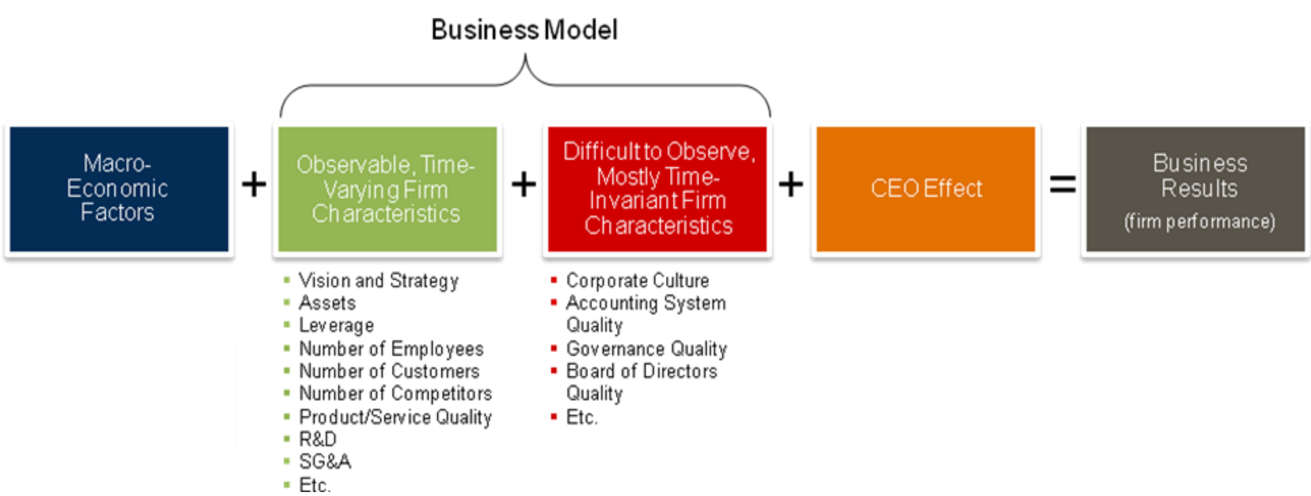
"Black swans" can appear at any time. Given significant and adverse economic events, which have occurred early in the twenty-first century, it is tempting to assert that we are living in a time especially prone to sudden surprises that can wash away business results. While it is true some decades are more turbulent than others, a quick review of the past two centuries (a Civil War in the United States, two World Wars, the Great Depression, the Korean War, global political upheaval of the 1960s, the Vietnam War, oil crises in the 1970s, the fall of the Berlin Wall, terrorism attacks, and the near collapse of the global financial system in 2008) demonstrates that uncertainty is simply a fact of commercial life. Macro-economic factors operating at the time of an analysis always account for some portion of the variance in business results.

The Business Model

Perhaps the factor that gets the greatest credit for positive business outcomes is the business model. By "business model," we mean the conceptual model by which the firm makes money—its "production function." A business model can be seen as the sum total of many firm characteristics, some that vary over time and are observable and others that do not vary much over time and are more difficult to observe.

The business model is reflected in everything from the vision and strategy to the asset base and corporate culture. Clearly the business model is the core of the business. Get this wrong and the ROA will be negative and the firm will likely go out of business. Figure 2 gives some detail about the factors, which taken together, constitute the business model of a firm.[4]

Figure 2



[4] We are indebted to Dr. Shane Dikolli, Assistant Professor of Accounting, Duke University Fuqua School of Business, for this working definition of a business model.

But when the above are taken into account—external forces and the business model—there is still more to the equation—more that must be explained to account for business results.

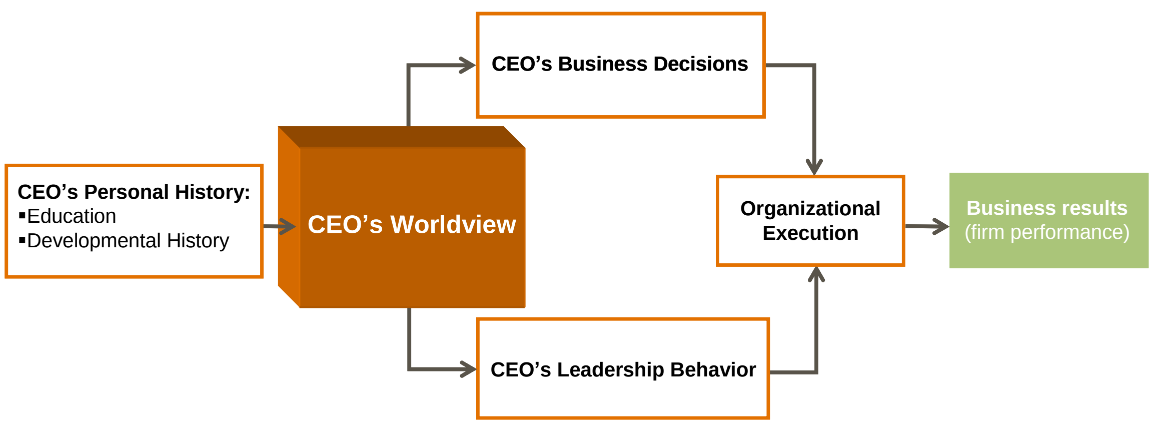
The "CEO Effect"

Almost all academic variance decomposition studies conclude with a percentage of variance that cannot be attributed to macro-economic factors or the business model. They simply attribute it to the "CEO effect." In fact, one study[5] published in 2008 claims that "CEOs can, in fact, have a substantial impact, explaining as much as 29.2 percent of the variance in a firm's performance."

So how can a CEO exert this much influence on a firm's performance? Common sense suggests the influence is due both to the business decisions the CEO makes—or doesn't make—and the CEO's leadership behavior. But these, in turn, we hypothesize, are guided by the CEO's specific worldview, which is a byproduct of the CEO's education and personal developmental history. But ultimately, no matter how excellent the CEO's decisions are or how impressive the CEO's behavior is, it all comes down to execution—the organization's capacity to execute the business plan. These five interrelated concepts are displayed by Figure 3. The balance of this paper will describe each of these in turn.

Figure 3

The CEO Effect



[5] Alison Mackey, The Effect of CEOs on Firm Performance, Research Notes and Commentaries, Strategic Management Journal, 29, 1357-1367 (2008)

CEO's Worldview: A Definition

Let's turn first to a definition of what we mean by "worldview," as it is a core concept of our research.[6]

We define a worldview as a set of assumptions, biases, beliefs, and automatic response patterns (ARPs) used by our brains to organize reality. A worldview operates like a software program within one's brain.

An individual's worldview acts as a filter with a set of implicit decision rules about what data should be ignored and what deserves attention. In addition, the worldview serves an interpretive function. It creates meaning out of raw data. Where one CEO sees a future fraught with risk and danger, another might see a future filled with exciting challenges and opportunity. Either view, we hypothesize, is primarily a function of one's worldview—how data is interpreted based on those assumptions, biases, beliefs and automatic response patterns. Finally, it guides behavior. Decisions are made and actions taken that generally align with the CEO's worldview.

Like all high-level skills, leadership is a complex interaction of the head and the heart. While we are neither medical researchers nor neuroscientists, some basic biological facts are easy enough to grasp. Two major body systems, the endocrine system and the nervous system, are in constant interaction with each other. The electrical energy of the nervous system and the chemically-laced juices of our endocrine system work together and have a profound impact on our behavior. Ideas and rational thought, as well as the electrical impulses sent to our muscles, all depend on the nervous system. Our moods and how we "feel" at any given moment are in large part dependent on our endocrine system's juices that are sloshing around. The endocrine system affects the nervous system and the nervous system affects the endocrine system. We are one complex, biologic interactive package.

Over years of experience, these bodily systems develop habitual pathways or patterns of interaction that become automatic and result in very predictable behavior patterns; for example, people who drive automobiles put a foot on the brake at a stop sign without attending to it—with no rational thought involved. We just behave this way automatically. This is an automatic response pattern (ARP). This behavior pattern occurs in a highly predictable fashion. With sufficient self-awareness and intention or a change in conditions one can break into awareness and intervene, either aborting an ARP completely or modifying it.

Daily life is filled with hundreds and hundreds of such behavioral decisions, and neuroscientists and social psychologists who research this concept claim that fully ninety-five percent of our minute-to-minute decision making is an

[6] For a more technical definition of the "worldview" concept, see the Notes section at the end of this paper.

automatic response—what we subjectively experience as rational thought is bypassed completely. The cerebral cortex is not involved.[7] This appears to be true for both mundane activities such as placing one's foot on a brake pedal to important decisions loaded with moral content—decisions that impact the welfare of other human beings. We often call these automatic decisions our "intuition" or "checking our gut," but we typically do that after the fact. We use this to explain our decisions when we can't come up with a good rational explanation: "It felt like the right thing to do."

The reader may be thinking at this point that we are hopeless automatons. If ninety-five percent of our daily decisions are made automatically, how can we see ourselves as rational decision makers who often behave in moral and noble ways? Many of our nation's business schools still ascribe to the view that people are completely rational and are also entirely self-interested. The good news is that we are neither hopeless automatons nor are we only self-interested. We are *both* self-interested *and* concerned about others, but most of our life, we are guided by our subconscious. Only occasionally are we guided by rational decision making!

One does not have to be held captive by first responses to every situation, although many people are more bound by their ARPs than they suspect. One can develop new ARPs. As we go throughout life, we are constantly evolving and changing our automatic response patterns, and sometimes in dramatic ways.

Despite the fact that we are guided mostly by our ARPs, the adage "old dogs can't learn new tricks" is not true. However, some "old dogs" choose to resist change more than others. But even old dogs are constantly changing and evolving in subtle ways. When deliberate change is desired, the change process first and foremost involves learning with great clarity the impact our first responses have on other people and then coming to understand both the cost and benefit that these automatic response patterns bring to us and our organizations. A choice can then be made about how one wishes to change. Conscious and disciplined practice is required to develop new patterns that replace the old ones.

We all know that a CEO has subconscious beliefs and seemingly automatic ways of responding in certain situations. In fact, the people who work closely with the CEO are usually able to predict some of these responses quite accurately. How many times have you heard a colleague say, "Oh, don't go into the CEO's office with that idea—it'll never fly!" Or conversely, "Oh, let's pitch this. He'll love it!" These statements reveal a certainty about at least some of the CEO's assumptions, beliefs, and automatic response patterns.

[7] Bargh, John A. and Chartrand, Tanya L. *The Unbearable Automaticity of Being.* July, 1999, American Psychologist. Vol. 54, No. 7, 462-479.

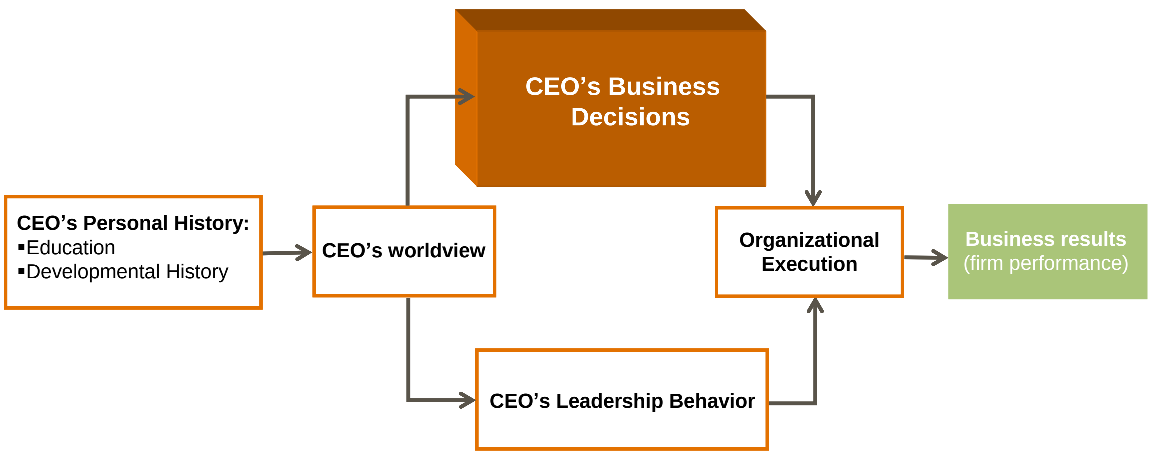
If it is true that a high percentage of an individual's daily decisions are driven by subconscious assumptions and beliefs (and there does seem to be general scientific agreement on this), then it seems obvious to us that shining a searchlight into this mysterious realm is wise. By demystifying the inner world of the CEO and decoding the powerful beliefs that drive effective decision-making and leadership, we will be able to create more powerful developmental and educational offerings.

Our intent with this research is to create a system and methodology for "mapping" this subterranean territory called the CEO's "worldview."

CEO's Business Decisions that Drive Business Results

Figure 4

The CEO Effect



The CEO holds his title for a good reason. The chief executive exercises the "executive" function in an organization—making the key decisions. While the ultimate power of the CEO's authority for decision making varies depending on the ownership structure, it is rare that a CEO does not have primary responsibility for making decisions in the following six areas:

1. Vision
2. Strategy
3. Investment policy
4. Risk tolerance
5. People decisions
6. Organizational strategy

Decisions in these areas basically determine the business model that the organization deploys to achieve business results.

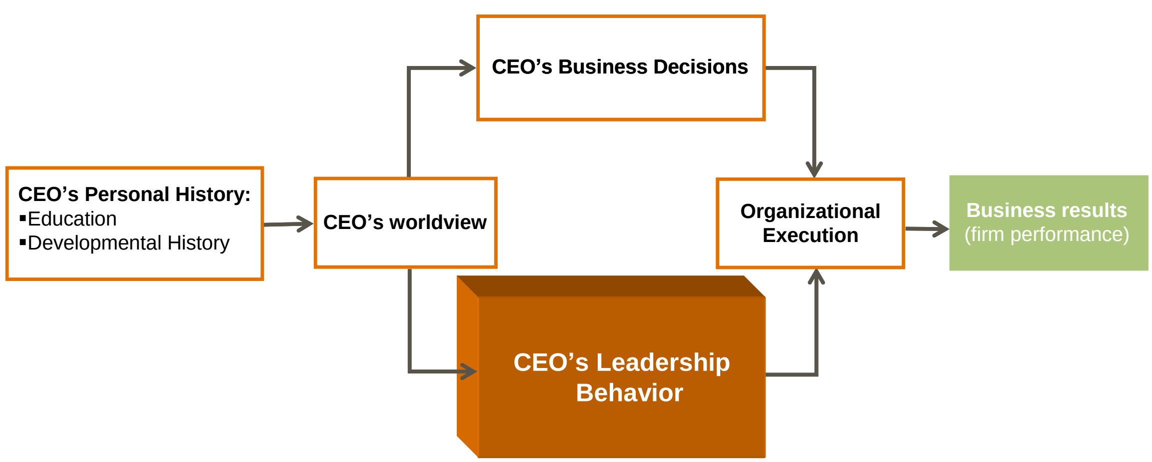
There is ongoing research about the impact of personality characteristics and personal history of the CEO on investment decisions and the assessment of risk. More than one research effort has studied optimism and self-confidence as factors that can impact business decisions. There seems to be a consensus that there is an optimal level of optimism and self-confidence for a CEO to possess, but excessive optimism and confidence lead to poor business decisions. Likewise, there is some evidence reported in the academic literature that shows older CEOs to be more conservative and risk averse. And possessing an MBA does seem to be a positive in some studies. High levels of compensation—such as that received by "star" CEOs—does not seem to yield a higher level of success. In fact, some studies report that many very highly paid CEOs "take their eye off the ball" and spend most of their time on their personal interests or in their outside-facing corporate role and neglect the business itself. [8]

Each of these studies is an attempt to unbundle and explain "the CEO effect." Because of data constraints, none of them pursue this research at a deeper level—to understand the impact a CEO's worldview has on business decisions and then, therefore, the way the organization executes the business plan.

CEO's Leadership Behavior That Drives Business Results

Figure 5

The CEO Effect



[8] There are several researchers exploring these topics. See Graham, Harvey & Puri, 2009; Puri & Robinson, 2006; Malmendier & Tate, 2005: Bertrand, 2008.

In addition to making the decisions listed in the previous section, the CEO is a leader. We have chosen to categorize the CEO's leadership behavior into the following five areas:

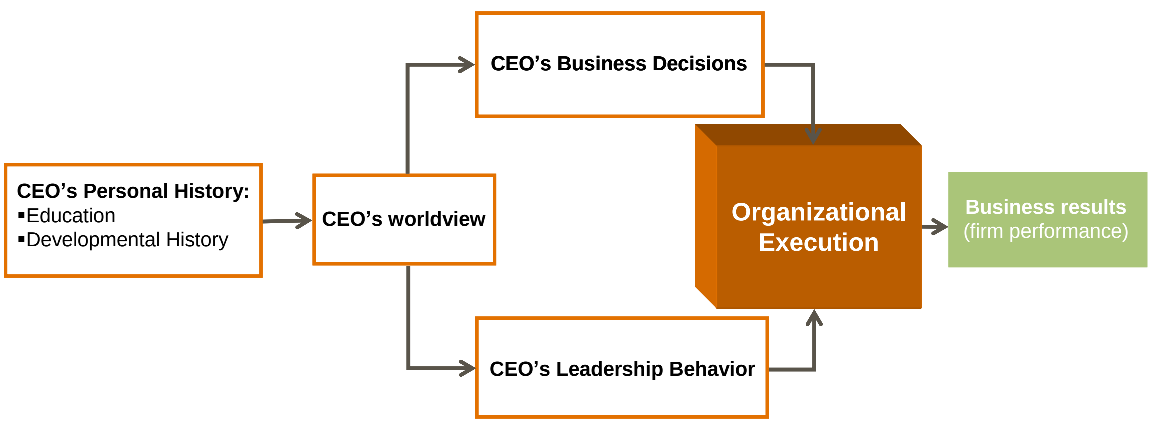
1. Tending to board relationships
2. Leading the senior team (setting goals; enforcing accountability; establishing key performance indicators; driving for results)
3. Releasing and managing organizational energy (energizing and inspiring the team and workforce)
4. Influencing (shaping and maintaining) the culture
5. Demonstrating the corporate values (walking the talk)

Every organization has to have a primary leader. It follows that the effectiveness of the CEO's leadership behavior impacts organizational execution, which brings about the business results. We have created a competency model of the chief executive job as a standard against which we can evaluate the CEOs in this research. (See Appendix A).

Organizational Execution

Figure 6

The CEO Effect



Execution is literally the bottom line for business organizations. The most elegant business model and brilliantly created strategies mean nothing if the execution is flawed. The organization's readiness to execute and ultimate level of effectiveness is a direct reflection of the CEO's decisions and leadership behavior. Organizational design and culture are shaped and maintained first and foremost by the CEO and in large part determine the success the organization will have in executing the business strategy.

We define an organization that has a high execution readiness level as possessing the following characteristics:

1. The vision and strategy are clear to all, right down to the front-line workers
2. Roles and responsibilities are clear and there is little confusion about decision making
3. People at all levels are held accountable
4. The leadership team maintains the focus on a few strategic initiatives
5. Leadership is intimately in touch with the market *and* the experience of the front-line workers

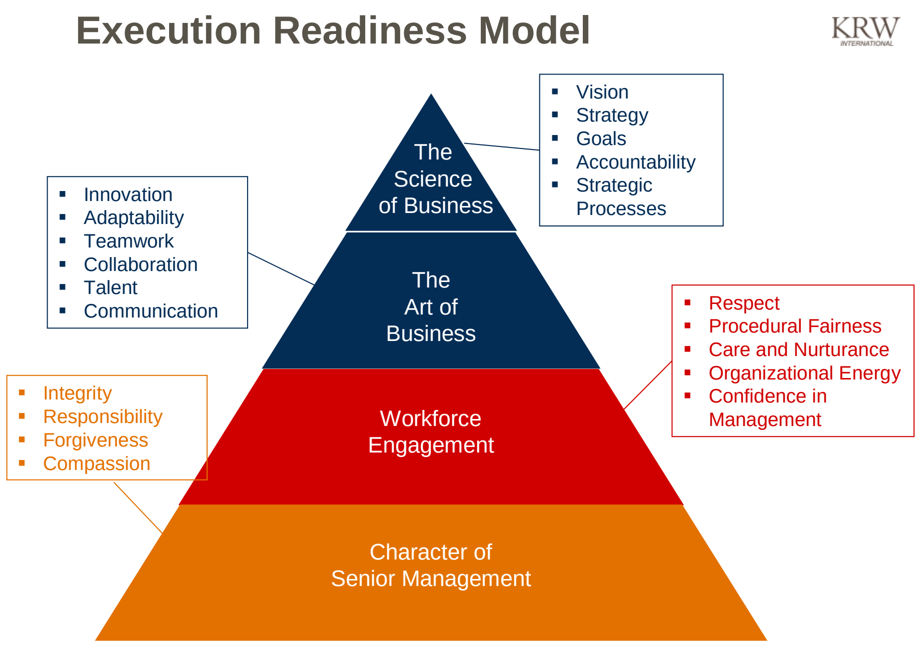
Or put another way, the *symptoms* of an organization that is *not* at a high execution readiness level are:

1. Unclear vision
2. Confusion about decision making
3. Little or no accountability
4. Lack of focus ("firefighting")
5. Executive isolation ("out of touch")

The Execution Readiness Model described graphically by Figure 7 provides additional detail about the conditions that we believe must be present for an organization to enjoy a high level of execution readiness. This model is described in a KRW Research Institute white paper[9]. In short, the model builds off of what we've learned so far about the role that the character of senior management plays in organizational life—leadership that is believed by the employees to be of high integrity and exhibits compassion, forgiveness, and a sense of responsibility will generally create an engaged workforce. If those conditions are aligned with an organization that has a good business model and that understands and implements both the art and science of business, there will be a higher probability of executing its strategy and business plan effectively and, therefore, delivering the desired results.

[9] Fred Kiel. White Paper Number 103: ***Assessing an Organization's Readiness to Execute.*** KRW Research Institute, April, 2009.:

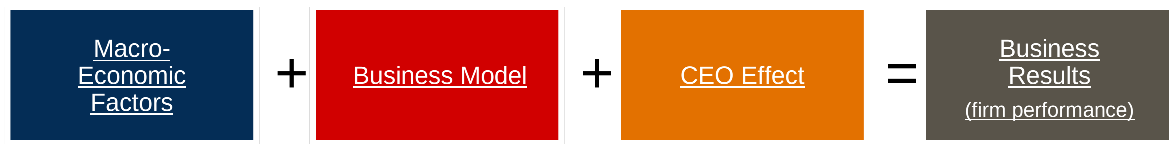
Figure 7



Summary: The CEO Effect

As described at the beginning of this paper, business results can be described as the outcome of three factors: macro-economic factors, the business model deployed by the business, and finally, the impact the CEO has on the level of organizational execution effectiveness, or the CEO effect.

Figure 8



We have asserted that the CEO effect is the impact of the decisions and leadership behavior of the CEO on the organization's readiness to execute. The CEO's decisions and leadership behavior are guided by the CEO's specific worldview, which in turn, is a byproduct of the individual's education and personal developmental history.

Questions about the Power of a CEO's Worldview to Create or Destroy Value

We hope to shed light on several important questions raised by the above model. The following is a partial list:

1. What portion of the variance in business outcomes (ROA) in our research sample is accounted for by the "CEO Effect"?
2. What are the assumptions, beliefs, and automatic response patterns (the worldview) held by CEOs that are predictive of positive business outcomes (create value)?
3. Likewise, what are the assumptions, beliefs, and automatic response patterns held by CEOs that are predictive of negative business outcomes (destroy value)?
4. Is there anything in the backgrounds and developmental experiences of the research CEOs that is predictive of either of these worldviews?
5. How much does it matter if a CEO demonstrates the moral competencies (integrity, responsibility, forgiveness, and compassion) we write about in *Moral Intelligence*?[10]
6. Does a CEO's moral competence have a statistically significant impact on:
   - Tolerance for risk
   - Investment policy
   - Organizational execution readiness level
   - Workforce engagement
7. What role, if any, does national culture have on the research findings?

Implications of this Research for Business Education

Most business schools offer ethics courses but these appear to have little impact on the students, as the rate of cheating on exams by business students is the highest among all professional disciplines. And unfortunately, examples of yet another business leader convicted of fraud appear almost daily in the news media. *The Christian Science Monitor*[11] reported in 2007 that "a recent study of fifty-four universities found fifty-six percent of graduate business students admitted to having cheated—more than in other professional schools in the survey."

When more than half of the MBA students in American business schools admit to cheating, we believe something is terribly wrong with how our society prepares future business leaders.

[10] For a listing of a behavioral definition of the moral competencies related to the four moral principles see: Doug Lennick & Fred Kiel. *Moral Intelligence: Enhancing Business Performance and Leadership Success.* Wharton School Publishing. 2005. See page 78.
[11] Duke's B-School Cheating Scandal. Christian Science Monitor, May 4, 2007 Edition.

The problem is not limited to American schools. A 2004 article in the *Journal of Education Management*[12] reported that "a number of international studies from schools throughout the world suggest that academic dishonesty is a widespread, insidious, and global problem."

If the results of this research demonstrate unequivocally that a specific morally acceptable worldview does indeed have a direct positive economic relationship with several measures of business performance—such as an increase in ROA—then it seems logical that business schools would encourage their students to adopt this worldview.

Some would assert that such matters as moral beliefs and ethical behaviors cannot really be taught; rather these patterns of responding and beliefs that form one's worldview are learned "at your mother's knee." We assert that this is not true. Exactly how one teaches budding business leaders to embrace a different worldview than the one they learned through personal life experiences may be a difficult challenge. But people do change, and sometimes do so dramatically. Just ask anyone who's experienced some kind of life-changing event and went on to adopt a distinctly new and different set of beliefs and assumptions about the world. Indeed, that is why these events are described as "life changing."

At a minimum, business schools have an obligation to raise their students' awareness and offer a scientifically valid way of assessing their specific worldview compared to the beliefs and assumptions that are known to create value. If students have a way of knowing how far off the mark they are, it will serve to motivate them to change. Business students are high achievers. If they become convinced that their future business success is dependent in part on engaging in a personal change process, our prediction is that these students will clamor for assistance from their business-school professors.

We believe a new approach to teaching ethics is clearly needed. We hope our research will provide the foundation for business schools to significantly impact the moral competency of its graduates and the business leaders of tomorrow.

[12] Chapman, Kenneth J; Lupton, Robert A. *Academic dishonesty in a global educational market: a comparison of Hong Kong and American university business students*. International Journal of Educational Management. Vol. 18, No. 6 (2004)

Notes

Definition: Worldview

A worldview is a constellation of mental processes, both conscious and subconscious, that create motivational states that in turn drive behavior.

These mental processes—one's worldview—are elicited both by conscious volition or will *and* by external stimuli. Conscious volition focuses on goals or purpose. External stimuli elicit automatic response patterns (ARPs). Both conscious choices and ARPs are influenced by one's personal history.

Beliefs are statements we make to ourselves by our internal self-talk as well as to external audiences. We make belief statements to:

- Explain—or rationalize—past behaviors or choices, both good and bad
- Assess a set of circumstances
- Predict how we will behave in the future

Research Design and Methodology: What We Measure

From the CEO:

- Top ten beliefs—self-reported "core convictions"
- Descriptions of corporate culture—open-ended questions
- Self-report of agreement/disagreement with 84 belief statements
- Self-report of moral competency behavior over four dimensions
- Assessment of business results compared to industry peers
- Voting history in presidential elections
- Assessment of emotional atmosphere/energy of organization
- Memories of childhood/family life over various dimensions
- Birth order
- Family dynamics in family of origin

From Three Samples of 100 employees**:**

Sample One:

- Assessment of the CEO's moral competency behaviors over four dimensions
- Assessment of middle management's moral competency behaviors over four dimensions
- Assessment of business results compared to industry peers
- Assessment of talent development practices within the organization
- Open-ended question about what it "feels" like to work in the organization

- Overall satisfaction rating

Sample Two:

- Assessment of congruence between theCEO's behavior and the 84 belief statements
- Stories about the CEO
- Assessment of the degree that a company is both doing well and doing good for its community
- Open-ended question about what it "feels" like to work in the organization
- Overall satisfaction rating

Sample Three:

- Assessment of senior management's moral competency behaviors over four dimensions
- Ratings of five dimensions of workforce engagement (respect, procedural fairness, care and support, organizational energy, and confidence in management)
- Assessment of business practices within the organization (clarity of vision, accountability, strategic focus, innovation, adaptability, collaboration, teamwork, and communication)
- Open-ended question about what it "feels" like to work in the organization
- Overall satisfaction rating

Appendix

Competency Model of a World-Class CEO

Who the CEO Is:

1. **A person of character** (demonstrates integrity, responsibility; compassion; forgiveness in everyday behavior)
2. **Purveyor of organizational energy** (optimistic; inspiring; displays contagious energy; engaged and committed)
3. **Collaborator and communicator** (Communicates with impact—clearly and concisely. Creates trust, develops relationships. Treats others with respect. Encourages open dialogue)
4. **Emotionally intelligent** (Perceptive, emotionally mature, manages own ego and demonstrates inclusiveness)

What the CEO Does:

1. **Tends to the Board**
   - Utilizes and leverages individual board members' expertise
   - Gains input and support from chairs of key committees
   - Asks for and supports board's responsibility to conduct a CEO evaluation
   - Works with chair to conduct a board self-evaluation
   - Helps the chair develop the board

2. **Maintains relationships with key stakeholders (investors, key customers, etc.) and the press**
   - Private
   - Public

3. **Vision and Strategy**
   - Leads the creation of a vision:
     a. a picture of a future state—three to five years out
     b. aspirational
     c. memorable and evokes strong emotions
   - Communicates the vision in inspiring ways to entire workforce
   - Sets strategy aligned with the vision
   - Gains alignment all the way to front line workers

4. **Executive Team Leadership**
   - Selects and develops talent with diverse points of view—gets "right people on the bus"
   - Creates and builds a high-performance senior team
     a. sets goals and performance standards
     b. holds people accountable and monitors key performance indicators
     c. stays out of the details yet is decisive in the face of complexity and uncertainty

5. **Shapes and Maintains a Culture Focused on Execution**
   - Monitors execution fitness level of organization
   - Removes barriers to execution
   - Champions and demonstrates the company values

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