

CEO Equity Risk Bearing and Strategic Risk Taking: The Moderating Effect of CEO Personality

Research published in *Strategic Management Journal* examined how CEO personality influences the way CEOs respond to stock option pay. The study examined the impact of four traits -- conscientiousness, extraversion, openness to experience and neuroticism -- on the relationship between stock option pay and strategic risk taking. The authors argued that CEOs tend to become risk averse as their option wealth increases but that this relationship depends on the CEO's personality.

Key Takeaways:

- Highly conscientious CEOs tend to be more risk averse as their option wealth increases.
- Highly extraverted CEOs tend to be less risk averse as their option wealth increases
- CEOs who score high on openness to experience tend to be less risk averse as their option wealth increases

The authors constructed personality profiles of 158 CEOs of S&P 1,500 firms in manufacturing and tracked their compensation and strategic risk taking in the form of long-term debt, R&D spending and capital expenditures. Following these CEOs from 2004 through 2012, the authors found conscientiousness strengthened the negative relationship between equity risk bearing and strategic risk taking. That is, highly conscientious CEOs – who are sensitive to the downsides of risk taking – were more risk averse as their option wealth increased. Extraversion and openness to experience weakened and reversed the

relationship between risk bearing and strategic risk taking. CEOs who scored high in extraversion and openness – who are sensitive to the upsides of risk taking – were more likely to engage in strategic risk taking as their option wealth increased. These findings were obtained controlling for CEO demographics, other aspects of their total compensation and firm size and performance.

The authors argued that the findings suggest the need to match compensation strategy to the risk taking preferences of the shareholders. Further, given their findings suggest that responses to equity risk bearing will be affected by personality traits, they argued that boards should consider personality when designing compensation packages. The authors caution that because they focused on manufacturing firms, the further research may be needed in other sectors.

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