



Spotlight

When Hiring CEOs, Focus on Character

Personal behavior can predict
which leaders might go astray.



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O N NOVEMBER 19, 2018, Carlos Ghosn, the chairman of Nissan, was arrested after stepping off his corporate jet in Tokyo. Japanese authorities criminally charged him for a host of financial misdeeds at Nissan, including misappropriating \$5 million and concealing about \$80 million of his compensation over eight years.

For Ghosn, who had saved Nissan from bankruptcy after arriving in 1999, it was a stunning comedown. He had joined the company as an outsider with Brazilian, French, and Lebanese citizenship, but he had become one of Japan's most recognized business leaders—nicknamed “Mr. Fix It” by an adoring public, celebrated in manga comic books, and awarded a medal by Emperor Akihito. After his arrest, Ghosn argued that the allegations were “meritless and unsubstantiated,”

ginned up by rivals within Nissan. Nonetheless, rather than stand trial, Ghosn hired a former commando to hide him in a music-equipment box and fly him by private jet to Lebanon, where he remains a fugitive.

Ghosn's saga was shocking. How could anyone have seen it coming? In fact, there were clues.

In 2014 and 2016, Ghosn threw lavish birthday parties at the Palace of Versailles for himself and his wife, perhaps with company funds. He and his family have owned a 120-foot yacht and upscale homes in Tokyo, Paris, Rio de Janeiro, Amsterdam, Beirut, and New York. He has invested in wineries and contemporary art. And even though he was awarded a compensation package four times as large as that of his counterpart at Toyota, Ghosn spent much of his tenure at Nissan complaining that he was underpaid.

Those behaviors—over-the-top spending, a focus on personal earnings, and an apparent disregard for rules such as company expense policies—should be warning signals for boards. In a series of studies over the past decade, colleagues and I have sought to identify off-the-job behaviors that foretell an executive's propensity for ethical lapses. Through this work we have pinpointed two traits—materialism and an inclination toward rule breaking—that correlate with suspicious trading activity, financial-reporting errors, and excessive risk taking. We've also devised novel ways to identify executives who exhibit those behaviors.

Examining CEOs' personal lives is an unorthodox method for preventing fraud. When boards, regulators, and investors consider ways to limit unethical behavior, the emphasis tends to be on systemic fixes, such as laws and regulations, large and well-funded compliance departments, heightened oversight, and reporting mechanisms such as whistleblower hotlines. That standard approach conforms with economic theory, which treats individuals as rational beings who will all respond similarly to incentives and rules.

My research suggests taking a different tack: assuming that leaders' personalities play a significant role in

how they behave, and that their private actions can affect organizational behavior. If this is true, then especially when hiring CEOs, boards should consider a person's character, with an emphasis on whether a candidate displays signs of materialism or a history of flouting rules. Ignoring those signs and installing a leader whose life away from the office raises red flags can put a company at unnecessary risk.

In the following pages, I first explain the evolution of my research and its specific findings. I then discuss the practical implications for regulators and for corporate boards involved in screening and selecting top executives.

