

Eugene Sadler-Smith

Hubristic Leadership

With a Foreword by
Lord David Owen



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A BEHAVIOURAL APPROACH

WISE WARNING

'There is a tide in the affairs of men which, taken at the flood, leads on to fortune; omitted, all the voyage of their life is bound in shallows and in miseries.' (Spoken by Brutus in *Julius Caesar*, Act IV, Scene III)

Introduction

This chapter looks at hubristic leadership through a behavioural lens. 'Behavioural science' is an umbrella term for the cross-disciplinary study of how people behave. It uses concepts and methods from fields such as behavioural economics, cognitive and social psychology and, increasingly, neuroscience to understand a diverse range of societal concerns.¹ The relevance of behavioural science research to social policy hit the headlines in 2010 when the UK's Coalition government, led by former Prime Minister David Cameron, set up the world's first government institute dedicated to behavioural science. The Behavioural Insights Team (BIT)² based in 10 Downing Street, also known as 'The Nudge Unit',³ was dedicated to the application of behavioural research to the betterment of society through improved decisions about health, wealth and happiness as well as, in an era of austerity, saving the government money.⁴

BACKGROUND

The significance of the 'nudge' concept, and behavioural science more generally, is such that one of its originators, Professor Richard H. Thaler of the University of Chicago, was awarded the 2017 Nobel Prize for Economics for his contribution to the behavioural sciences.⁵ Indeed, Thaler himself pointed towards the significance of hubris-infected

behaviours when he highlighted the pervasiveness of undue confidence and optimism in human affairs even when the stakes are high. For example, people generally rate themselves as less likely than others to get fired from their job, get divorced, get sick, or have an accident. If evidence were needed of how unbounded human optimism and confidence can be, look no further than the popularity of national lotteries where in the UK the approximate odds of winning the 'Lotto' jackpot are 1 in 45 million; nonetheless, millions of hyper-optimists are willing to gamble the minimum £2 stake on a weekly basis.⁶

Behavioural science was topical enough to be subjected to the penetrating gaze of Her Majesty the Queen on the occasion of her visit to the London School of Economics (LSE) in November 2008. Her polite but piercing enquiry as to why no one had noticed beforehand that the 2007 financial crisis was on its way, prompted the following formal reply to Buckingham Palace from a group of highly respected members of the British Academy:

'most [experts] were convinced that banks knew what they were doing. They believed that the financial wizards had found new and clever ways of managing risks. Indeed, some claimed to have so dispersed them through an array of novel financial instruments that they had virtually removed them. It is difficult to recall a greater example of wishful thinking combined with *hubris*.' (British Academicians' Letter to The Queen, 22 July 2009, emphasis added)

With hindsight, what is perhaps surprising is that behavioural scientists of a variety of persuasions in fact had long known about the downsides of hubristic over-confidence and over-ambition, but many of them chose to overlook the problem. The result was a collective short-sightedness amongst researchers and financiers, the consequences of which have been highly damaging both economically and societally. But hubris has not only plagued decision making in banking and finance; its insidious effects have reached more broadly into leadership in business strategy, entrepreneurship and other aspects of business management, so much so that hubris has been referred to as nothing less than an 'epidemic' (Garrard, 2018).

HUBRIS IN BEHAVIOURAL CORPORATE FINANCE: THE HUBRIS HYPOTHESIS

The best starting point for this survey of the behavioural perspective on hubris is a foundational corporate finance theory formulated almost a quarter of a century before the 2007 financial crisis by Professor Richard Roll of UCLA's Anderson School of Management. Richard Roll's so-called 'Hubris Hypothesis' is important for two reasons: first, he was the earliest researcher to investigate systematically the impact of over-confidence on the value of a firm; second, the Hubris Hypothesis programme of research represents the most extensive body of knowledge in the behavioural sciences on the nature, causes and effects of hubris at the top of business organizations.

It was Roll's work that provided a catalyst for further research which branched out into studies of CEO over-confidence, self-concept and related issues in areas such as strategic management and entrepreneurship. Behavioural researchers more generally have come to treat over-confidence, over-ambition and over-optimism (e.g. unrealistic optimism and unrealistic ambitions) as sources and manifestations of a more general class of cognitive biases and errors in organizational decision-making processes, a number of which stem from inappropriate uses of heuristics and intuitive judgement (Gilovich et al., 2002). Biases of over-confidence, over-ambition and over-optimism, when allied to pride, arrogance and contempt for the advice and criticism of others, constitute hubris, and as we know, hubris is a hazard both for individuals and organizations.

Roll's ground-breaking contribution to hubris research takes as its starting point an assumption that is radically different to that which has been the cornerstone of classical economics. The latter assumes that the environment, combined with the assumption of perfect rationality on the part of the actor, determines economic behaviour; this is an unrealistic position, as pointed out by Simon (1979). Behavioural corporate finance, on the other hand, substitutes traditional economic assumptions of rationality with what was once a radical supposition – but now no longer disputed – that 'some agents are *not* fully rational' (Thaler, 2005: 1, original emphasis). This way of thinking is highly germane to the study of hubristic leadership because it embraces the study of decision makers who have been 'infected' by over-confidence, over-optimism and even recklessness, as well as weak intuitions and other cognitions and behaviours which crowd out rationality and intelligent restraint and give rise to irrational exuberance as a consequence of 'unbridled intuition' (Claxton et al., 2015).

Roll proposed the Hubris Hypothesis in a milestone article – 'The Hubris Hypothesis of Corporate Takeovers' – in the *Journal of Business* that has, at the time of writing, been cited over 4000 times since its publication in 1986. By way of comparison, Nobel Laureate Herbert Simon's seminal *American Economic Review* article on the paradigm-shifting concept of 'bounded rationality' referred to above has been cited an-almost-as-impressive 3000 times.⁷ Roll was interested in questions regarding the motivations behind merger and tender offers and whether or not takeovers actually result in an increase in a firm's market value. In essence, the Hubris Hypothesis makes a straightforward claim: firms who are acquiring other businesses ('acquiring firms') simply pay too much for their targets as a result of the hubristically over-confident judgement on the part of acquiring executives that they, not the market, know best what the value of the acquisition to the combined business is likely to be. The hubristic leaders of acquiring firms over-estimate the likelihood that the decisions *they* take will be successful and that it is *they* – and sometimes *they alone* – who can ensure success (Hayward et al., 2006).

Roll's hypothesis predicts – on the basis that hubrists over-pay for their acquisitions – that around the time of the takeover, the combined value of the target and bidder firms falls slightly because, put simply, the value of the bidding firm decreases by more than the value of the target firm increases (see below). The premium that bidding executives are

willing to pay for a potential acquisition reflects their hubristic beliefs about how much additional value they believe they can extract from the target firm, and this premium ‘underscore[s] acquiring managers’ [executives] convictions that the target’s pre-existing stock price inadequately reflects the value of the firm’s resources and its prospects, and that in the right hands – *their hands* – more value can be created’ (Hayward and Hambrick, 1997: 103–4, emphases added). In this respect, as well as being over-confident, bidding firm managers also appear to be under the ‘illusion of control’, that is they over-emphasize the extent to which their skills can improve performance whilst under-emphasizing the role of chance and other factors (Langer, 1975; Simon et al., 2000). Bidding firm managers not only think they can run the target firm better than the target firm managers, they also believe that they, rather than the market, know the true value of the acquisition⁸ (Table 5.1).

Table 5.1 Core features of Roll’s Hubris Hypothesis (Roll, 1986)

Bidding executives convince themselves that their estimated value for target firm is correct
Bidding executives assume market does not reflect true economic value of combined firm
Hubris-infected bidders end up paying too much for their acquisitions
Around a takeover, the combined value of bidder and target will fall
Value of the bidding firm should decrease whilst the value of the target firm should increase
Total combined takeover gain to bidding and target firm shareholders ends up non-positive (i.e. zero or negative)

As well as these immediate and short-term effects, there are potential financial and wider consequences further down the line. The premium paid can inversely affect acquirer shareholders’ return for several years following the acquisition date, moreover it is not unknown for excessive premiums to have devastating effects – even to the point of bankruptcy – because of the debts incurred in hubristically driven takeovers (Hayward and Hambrick, 1997).

Numerous studies have demonstrated ‘hubris effects’ consistent, to varying degrees, with Roll’s original hypothesis (e.g. Al Rahahleh and Wei, 2012; Antoniou et al., 2008; Ashta and Patil, 2007; Brown and Sharma, 2007; Chen and Wang, 2012; Ismail, 2008; Lin et al., 2008; Majumdar et al., 2010; Pangarkar and Lie, 2004; Sharma and Ho, 2002; Shih and Hsu, 2009). (For a review and assessment of Hubris Hypothesis research, see De Bodt et al., 2014; Picone et al., 2014.) Perhaps Valle’s (1998) metaphor of the ‘fairytale prince’ is apt: hubristic CEOs may pay well over the market value for a target firm in the fixed, but typically false, belief that it is their ‘kiss’ that will turn a ‘toad’ into a ‘prince’. Regrettably in corporate finance, as in life more generally, the fairytale rarely comes true – acquisitions more often than not result in a decline in the acquirer’s longer-term profitability; a hubristic manager’s kiss turns a toad into a prince only on rare occasions (Valle, 1998).

EXECUTIVE OVER-CONFIDENCE, CELEBRITY AND CONTROL

Confidence is an invaluable executive attribute; it enables executives, and their firms, to do things they would not otherwise have done and to take their firms in new, innovative technological directions (Galasso and Simcoe, 2011; Tang et al., 2015). On the other hand, hubristically over-confident CEOs often make value-destroying investment decisions, even though they do not set out to be destructive and act on an ‘honourable stewardship of corporate assets’ principle (Roll, 1986: 214). Finance researchers have further developed the Hubris Hypothesis theory by studying the effects of over-optimism (the systematic over-estimation of the probability of good firm performance and under-estimation of bad firm performance) and over-confidence (the distortion of corporate investment decisions such that over-confident managers over-estimate the returns on their investment projects) (Heaton, 2002; Malmendier and Tate, 2005a). Table 5.2 summarizes some of the psychological mechanisms that drive CEO over-optimism and over-confidence.

Table 5.2 Sources of CEO over-confidence

Source of CEO over-confidence	Description
Better-than-average effect	Individuals in general tend to consider themselves ‘above average’ on positive characteristics, for example most people will rate their driving skills as above average (Alicke et al., 1995)
Attributions of causality	Individuals tend to attribute successful outcomes to their own actions (a ‘self-serving attribution’) whereas failure is put down to ‘bad luck’ (Miller and Ross, 1975)
Base-rate neglect	CEOs’ inaccurate over-estimations of their abilities may emanate from their comparing themselves to a population average (for example, the ‘average manager’), rather than ‘average CEO’, since in the upper-echelons of organizations there are few other comparators against which CEOs can make accurate self-evaluations (Malmendier and Tate, 2005a)

A further cradle of over-confidence which fans the flames of CEO hubris is the ‘celebrity status’ that has come to pervade the upper echelons of popular business culture. The fabled CEO superstars – irreplaceable, iconic and heroic leaders such as Jack Welch, Steve Jobs or Jeff Bezos – are now an accepted part of the way business is conducted. Moreover, the trend towards CEO glorification has been fuelled by ‘CEO of the Year Awards’.⁹ But the consequences for the firm can be far from trifling. The phenomenon of the celebrity CEO can often be a process of dramatic rise and fall that is co-created between the CEO, susceptible followers and the media – and, when hubris becomes involved, the drama can turn into a tragedy (Figure 5.1).

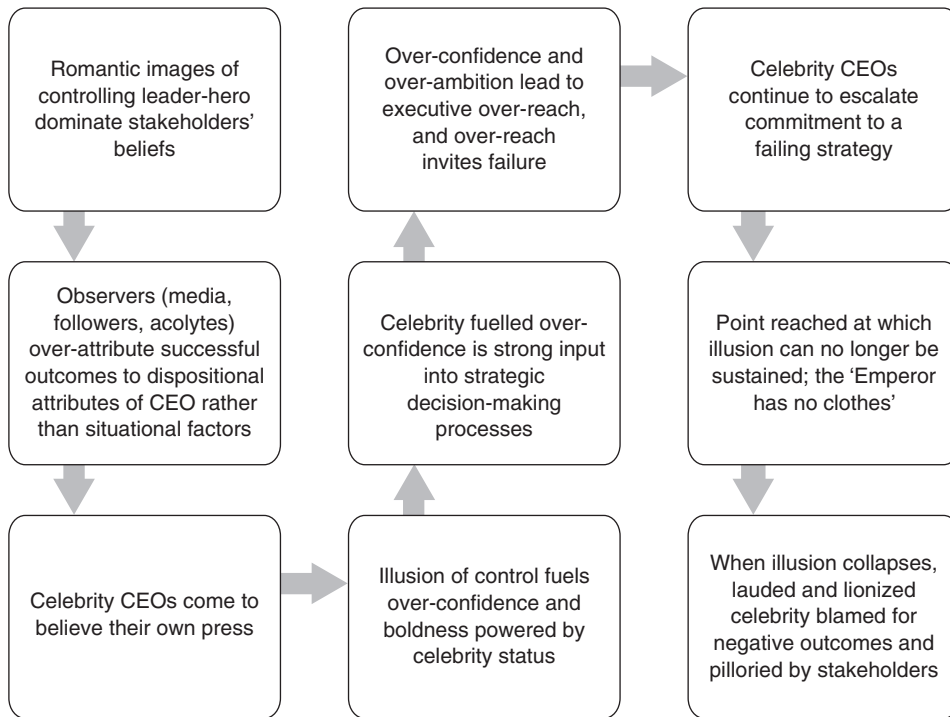


Figure 5.1 The drama and tragedy of CEO celebrity rise and fall (Hayward et al., 2004; Sinha et al., 2012)

Celebrity status has undesirable associations with CEO remuneration and other negative connotations. Researchers found that ‘superstar CEO’ status (for example, as ratified by major business awards) appears to distort CEO behaviour and can actually be associated with decreases in subsequent firm performance and increased total compensation relative to the next-highest paid executive (Malmendier and Tate, 2009). Award winners not only tend to extract higher compensation from their business in the form of stock and options, they also engage in distractions such as sitting on outside boards as well as petty diversions, for example by writing popular business books or playing more golf, all of which add little benefit to the firm (Malmendier and Tate, 2009). The same study also found that long-term underperformance of superstar CEOs and unrestrained increases in their equity-based compensation were typical of firms with weak corporate governance. The potential consequences for shareholders can be grim, and, for a weakly-governed business, having a ‘superstar’ at the helm who turns hubristic may end up being more of a curse than a blessing.

Successful executives, like all of us, whether they are celebrities or not, are likely to be labouring under some degree of illusion of control (Langer, 1975). People in general, including executives, prefer to be able to exercise control over events and their environment. Being unable to exercise control can be a source of insecurity and anxiety, whereas being able to

exercise control can be a source of security and optimism (Dutton, 1993; Thompson et al., 1998). Even with a random event such as throwing a dice, people like to do it themselves rather than have someone else do it for them. The illusion of control can be especially strong amongst executives who prefer to reject the notion of uncontrollable risk and instead prefer to stick to the view that risky situations are nothing more than another challenge to be overcome (Highhouse, 2001). The problem is likely to be amplified by narcissistic and hubristic executives because they prefer to receive the credit for success even when it can be attributed objectively to other sources or to luck (Hayward and Hambrick, 1997; March and Shapira, 1987).

HUBRIS IN STRATEGIC MANAGEMENT RESEARCH

In further developing the idea of hubristic leadership and addressing some of the shortcomings in Roll's original theory, strategic management researchers used a behaviourally rather than financially based definition of hubris. They also used research methods which went beyond the Hubris Hypothesis assumption that a negative market reaction indicates hubris. The definition of executive hubris was sharpened up by adopting a definition from *Webster's Dictionary*: 'exaggerated pride or self-confidence often resulting in retribution' (Hayward and Hambrick, 1997: 106), and the research used decision makers themselves as the unit of analysis rather than the firm. They predicted that hubris would affect two outcome variables: (1) 'acquisition premium' calculated as purchase price minus the pre-takeover (30-days) price, divided by the pre-takeover price; the higher the executive hubris the higher the premiums paid; and (2) cumulative abnormal returns (CAR) (measure of firm performance): an abnormal return to a stock is the portion of the return not anticipated in a model of anticipated, or 'normal', returns which means that a 'positive abnormal return' indicates that the market has upwardly revised its expectations of future returns from the stock and vice versa. The researchers' predictions were that 'acquisitions will tend to destroy value for acquiring firms' shareholders' and the 'greater the CEO's hubris, the worse the subsequent performance of the acquiring firm' will be (Hayward and Hambrick, 1997: 111) – more hubris should mean lower CAR.

In developing a testable research model, three sources of CEO hubris (assembled under the heading of 'The Hubris Factor') and three sources of weak board vigilance were identified (Hayward and Hambrick, 1997: 114). 'Acquisition premium' (see above) was measured in terms of how much above pre-bid market prices CEOs paid for acquisitions (in their data, this averaged 47 per cent but reached as high as 100 per cent) and this was taken to be a direct assessment of how much more valuable hubristic CEOs thought the acquired company would be under their 'exceptional-in-their-own-estimation' leadership.

CEO Hubris (The Hubris Factor) was comprised of recent organizational success, media praise for CEOs, and CEOs' self-importance, and it was predicted to have a detrimental effect

on acquiring firms' performance following an acquisition. Acquiring firm performance was measured as stockholder returns for the previous 12 months. Media praise for CEOs was determined by means of a content analysis of national newspaper and magazine articles covering the CEO (in *The New York Times*, *Wall Street Journal*, etc.) published in the three years leading up to the acquisition. CEO relative compensation was used as a measure of CEO self-importance (CEO cash compensation divided by compensation of second-highest paid company officer). The research also looked beyond the individual and argued that the relationship between CEOs' overall hubris and acquisition premiums is likely to be affected by the strength or weakness of the board and its degree of vigilance in either reining in or giving free rein to hubristic CEOs' valuations (Hayward and Hambrick, 1997).

In terms of *weak board vigilance*, the researchers predicted that the effect of CEO hubris would be accentuated by three board-level factors: (1) the consolidation of the board chair and CEO positions, since CEOs who also chair boards are more likely to recommend their personal choices without restraint; on the other hand, if there is a separate board chair, he or she may be in a position to rein in reckless acquisition decisions; (2) a high proportion of insiders on the board could result in board members being unwilling to challenge and therefore more subservient to CEOs, and create the space for unfettered CEO discretion and hubris; and (3) board vigilance is more likely to be weak if outside board members have little financial stake in the company (Table 5.3).

Table 5.3 The Hubris Factor and weak board vigilance (Hayward and Hambrick, 1997)

The Hubris Factor	
Performance	Stockholder returns for previous 12 months
Praise	Content analysis of national newspaper and magazine articles covering the CEO (in <i>New York Times</i> , <i>Wall Street Journal</i> , etc.)
Pay	CEO self-importance as CEO relative compensation (CEO cash compensation divided by compensation of second-highest paid company officer)
Weak board vigilance	
CEO–chair duality	Consolidation of the board chair and CEO positions
Too many insiders	High proportion of insiders on the board
Outsiders with low stakes	Outside board members have little financial stake in the company

Based on a study of 106 publicly traded transactions of US firms between 1989 and 1992, the researchers found that premiums paid for acquisitions were related positively to the Hubris Factor (i.e. acquiring firms' recent performance, media praise for acquiring firms' CEOs, and CEOs' self-importance). They also found that all three components of the Hubris Factor were associated with negative acquisition outcomes. There were two important further findings: first, the percentage of insider directors on the board heightened

the effect of the Hubris Factor on acquisition premiums; second, the consolidation of the CEO and chairman positions amplified the association between the Hubris Factor and acquisition premiums. The behaviour of hubristic CEOs who, in the researchers' estimation, were 'overconfident, very powerful, very greedy' was associated with negative effects on the acquisition process (by over-paying) and on outcomes (Hayward and Hambrick, 1997: 124). This research shows that the Hubris Factor allied to weak board vigilance is likely to be a financially damaging combination for a firm.

Hubris is linked both to risk-taking behaviour and the level of managers' discretion and as such it presents a hazard when: (1) risk taking is encouraged by a conducive business environment; and (2) risk taking is disinhibited by ineffective governance. It is likely that, because of an over-estimation of their own problem-solving abilities and an under-estimation of what could go wrong, hubristic CEOs will interpret risky situations as being less risky than they actually are (Camerer and Lovallo, 1999). When this misjudgement is allied to an under-estimation of the resources required, the firms' resource endowments and the uncertainties faced in carrying decisions forward, then the potential for risky decision making is magnified (Kahneman and Lovallo, 1993; March and Shapira, 1987; Shane and Stuart, 2002). Firms need to be mindful of CEO hubris not only when the Hubris Factor is allied with weak board vigilance, but especially when market conditions are conducive to risk-taking behaviours (Figure 5.2).

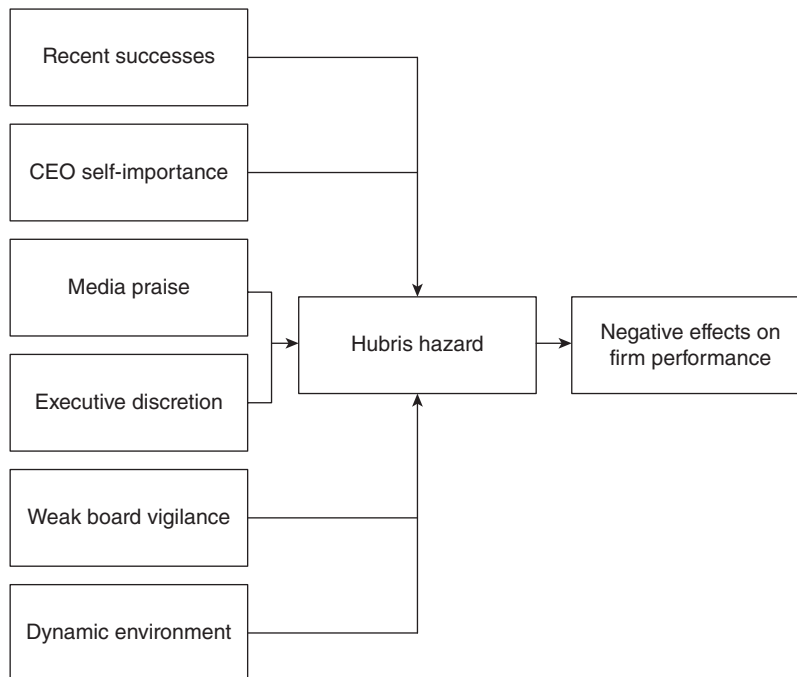


Figure 5.2 The components of the hubris hazard in strategic management

MEASURING EXECUTIVE HUBRIS

As well as investigating relationships between CEO hubris and relevant firm-level outcomes, strategic management researchers have also suggested how to measure CEO hubris as a psychological construct. The umbrella concept of ‘core self-evaluation (CSE)’ (Judge et al., 1998, 2003) has been proposed as a proxy measure for hubris on the basis that in its extreme form – as ‘hyper-CSE’ – it aligns closely with what is ‘often colloquially called “hubris”’ (Hiller and Hambrick, 2005: 297). CSE is a deeply-sourced dispositional trait concerned with how one evaluates oneself. It is the ‘common core’ of four human qualities or component traits: (1) self-esteem, for example ‘I am worthy’; (2) generalized self-efficacy, for example ‘I succeed at tasks’; (3) locus of control, for example ‘Life’s events are within my control’; and (4) emotional stability/neuroticism, for example ‘I am free from anxiety/am anxious’ (Hiller and Hambrick, 2005: 299) (Table 5.4).

Table 5.4 Core self-evaluation (CSE) component traits and measurement

Core self-evaluation components	Measure (Judge et al., 1997)
Self-esteem, for example ‘I am worthy’	10-item ‘Self-esteem’ scale from Rosenberg (1965)
Generalized self-efficacy, for example ‘I succeed at tasks’	10-item scale developed by Judge et al. (1998)
Locus of control, for example ‘Life’s events are within my control’	‘Internality’ subscale of Levenson’s (1981) Internal, Powerful Others, and Chance (IPC) Scale
Emotional stability/neuroticism, for example ‘I am free from anxiety/am anxious’	12-item ‘Neuroticism’ scale from the NEO-FFI Personality Inventory (Costa and McCrae, 1992)

Researchers have theorized that hyper-CSE is likely to be: (1) related positively to healthy narcissism and negatively to unhealthy reactive narcissism; (2) associated with less comprehensive (i.e. more ‘instinctive’) decision-making processes, faster strategic decision making and more centralized decision making; and (3) associated with more large-stakes projects undertaken and initiated by the CEO, with more deviation from the central tendencies of the industry, greater persistence in pursuing strategies initiated by the CEO, and more extreme performance (Hiller and Hambrick, 2005).

The researchers have framed core self-evaluation (as opposed to hyper-CSE) as a ‘bright side’ leadership trait associated with articulating a vision in such a way as to build commitment, being a role model, empowering others and having a realistic sense of their own and their organization’s capabilities. In a study of core self-evaluations amongst 75 CEOs of Major League Baseball organizations, positive relationships were found between core self-evaluations and transformational leadership (articulating a compelling vision, fostering goal commitment, and role modelling) (Resick et al., 2009). Given the relationships between CSE and transformational leadership (cf. charismatic leadership),

it would be interesting to study the relationship between hyper-CSE and ‘personalized’ (dark-side) charisma linked to a need for influence or power (Conger and Kanungo, 1998; House and Howell, 1992).

By studying CSE in business venturing environments, researchers also found positive relationships between CEOs’ core self-evaluations and their firms’ ‘entrepreneurial orientation’ (i.e. innovativeness, risk-taking propensities, and proactiveness) (Simsek et al., 2010). This suggests that being entrepreneurial entails high self-esteem, self-efficacy, locus of control and emotional stability, however being entrepreneurially successful rather than simply boldly, and perhaps recklessly entrepreneurial is likely to entail exercising these qualities in the right amounts in the right circumstances. An important question for business researchers, as well as a challenge for entrepreneurs and executives, is where does productive CSE stop and unproductive hyper-CSE begin?

More generally, the developments in strategic management research have added considerably to our understanding of concepts related to hubris such as confidence and over-confidence, core self-evaluation and hyper-core self-evaluation, and so on. These are summarized in relation to more fundamental distinctions such as hubris and narcissism in Table 5.5.

Table 5.5 Behavioural constructs in relation to other hubristic leadership concepts

Construct	Description
Hyper-core self-evaluation (CSE)	Excessive levels of self-efficacy, locus of control, emotional stability and self-esteem (Hiller and Hambrick, 2005)
Hubris	A psychological state characterized by over-confident and over-ambitious judgement and decision making, associated with the acquisition of significant power and success, and invulnerable to and contemptuous of the advice and criticism of others (Finkelstein et al., 2009; Sadler-Smith et al., 2016)
Hubris Syndrome	Behavioural transformation of a leader’s personality associated with the acquisition of significant power, recognizable in terms of 14 symptoms, five of which are unique to the condition (Owen, 2006; Owen and Davidson, 2009)
Narcissism	Relatively stable individual difference consisting of grandiosity, self-love and inflated self-views; exists on a continuum; narcissists are preoccupied with having their inflated self-view reinforced (Campbell et al., 2011: 269)
Over-confidence	Cognitive bias towards over-estimating the likely positive outcomes of future events (Dowling and Lucey, 2014) based on over-estimation of one’s abilities and over-precision in one’s beliefs
Pride	Authentic pride: positive emotion felt upon recognizing one’s actual contribution to a desirable outcome Hubristic pride: negative emotion associated with arrogance, conceit and self-aggrandizement (Bodolica and Spraggon, 2011; Tracy and Robins, 2014).

Researchers have also suggested that pride is related to hubris and have distinguished two facets of pride: 'hubristic pride' and 'authentic pride' (Tracy and Robins, 2014). Authentic pride is a positive emotion felt upon recognizing one's actual contribution to a desirable outcome, whereas hubristic pride, which is the 'dark side' of pride, is associated with arrogance, conceit and self-aggrandizement (Bodolica and Spraggon, 2011; Tracy and Robins, 2014). In a media commentary, Jessica Tracy, Professor of Psychology at the University of British Columbia, has suggested that Donald Trump typifies many of the attributes of hubristic pride (having a grandiose and inflated sense of self, egotism, arrogance, conceitedness, problematic relationships; being disagreeable, anti-social, aggressive and unempathetic):

Trump fits that model every step of the way. Any time he's challenged, his immediate response is to attack outwards. He's going to show everyone who tries to criticize him that they shouldn't do that because he will retaliate. This is his strategy, this is his way of getting power. And like it or not dominance is an effective way of getting ahead and it's worked quite well for him.¹⁰

The real estate business in which Trump appears to have excelled is a very different arena to the political sphere. Whilst high levels of self-confidence and ambition in real estate may have produced dividends for him and his business empire, it is not justifiable to assume that real-estate deal- and decision-making skills are transferable to the radically different fields of national and international politics. Domain specificity and lack of transferability of skills are likely to be an additional source of hubristic over-confidence in leaders who switch between significantly different fields.

HUBRIS, GROUPTHINK AND UPPER ECHELONS

Hubris is not solely down to the leader. Hubristic leadership may also arise because of social processes within groups, for example highly cohesive groups might limit their searches for alternatives, become over-confident in their collective judgements and, as a result, 'two heads may not be better than one' (Puncochar and Fox, 2004). Researchers have identified 'groupthink' as a potential source of hubris in business organizations (Kroll et al., 2000).

Groupthink is invoked when strongly cohesive groups (such as top management teams) are insulated from outside influences, have directive leadership, and the group processes produce attitudinal or ideological homogeneity (Janis, 1982). Groupthink provokes an over-estimation of the in-group (as stronger, smarter, superior, etc.) and a consequent under-estimating of the out-group (as weaker, more stupid, inferior, etc.) (Janis and Mann, 1977). Groupthink promotes closed-mindedness and pressures for uniformity and

conformity, and could be a significant contributor to organizational hubris (see Chapter 6) through the formation of 'in-groups' as a result of differential social exchanges between leaders and followers (see Chapter 7).

A consequence of this is that overly cohesive and isolated groups can become more prone to sub-optimal decision-making processes because of flawed and/or incomplete information search, inadequate contingency planning and biased assessments of the risks and costs/benefits, as well as the moral implications (such as inadequate consideration of human impacts). One of the problems of prior success – a key factor fuelling hubris – is that it can foster complacency, inattention to detail, routinization and habituation, and breed over-confidence. The upside of failure, on the other hand, is that it can remind managers and leaders of the need for constant vigilance (Starbuck and Milliken, 1988). Ironically, repeated successes can result in errors in decision making being more likely, whilst significant failures can reduce the chances of costly errors if they result in learning. Overly cohesive groups can take decisions that are hubristically insensitive to the likelihood and consequences of failure (Baron, 2009).

Two examples of the consequences of collective, or organizational, hubris are to be found at NASA and the twin space-shuttle disasters of Challenger (in 1986) and Columbia (in 2003) which led to the deaths of 14 astronauts. Researchers have argued that NASA's organizational culture had become 'infested with hubris' (Mason, 2004: 134). Over-confidence influenced the organization's attitudes towards safety, whilst contempt was thought to have been an issue in managers' and executives' attitudes towards knowledge experts (Boin and Schulman, 2008; Garrett, 2004). A hierarchical structure concentrated decision-making power at the top in a culture of self-assurance and a historical context of spectacular prior successes (for example, the Apollo programme which landed the first astronaut on the moon). These factors amounted to a potentially dangerous 'over-confidence trap' in a technical context which was highly complex, inherently unruly and ultimately unpredictable (Mason, 2004). Organizational hubris (see Chapter 6) invited disastrous outcomes that materialized in two catastrophic failures.

Upper echelons theory (UET) is based on bounded rationality (Simon, 1979) and the assumption that in order to understand strategic management it is essential to consider the biases and dispositions of top executives. UET proposes that executives' experiences, values and personalities influence their interpretations of the situations they face and thereby affect the choices they make (Hambrick and Mason, 1984). Counter to the criticism that UET glorifies organizational elites, one of the originators of the theory, Donald Hambrick of Penn State University, made the point that executives are just as prone as other managers to cognitive biases, preening, selfishness, over-ambition and hubris (Hambrick, 2007). By way of illustration, an upper echelons study that explored reasons why directors in the banking industry did not foresee the problems of excessive

risk in the lead-up to the financial crisis, found that in high-uncertainty environments experts and males (cf. the ‘winner effect’) have a higher inclination to under-estimate financial risk than non-experts and women, and that the problem is amplified by top management team (TMT) homogeneity (Rost and Osterloh, 2010). In keeping with the findings of neuroscience (see Chapter 3), it seems that behavioural research points to the need for greater diversity of knowledge, experience and gender at the top of organizations as a means of combatting the hubris hazard.

ENTREPRENEURSHIP

Entrepreneurs take significant risks in the pursuit of business success. To do so they need to be confident, ambitious and optimistic in deciding to embark on a new venture. A high level of confidence has many advantages, for example it can be beneficial in persuading others to be enthusiastic about joining in a business venturing project, and it can inspire, motivate and assure employees (Busenitz and Barney, 1997). However, the uncertainties faced, the risks involved and the gains to be made also involve a delicate balance between confidence and over-confidence, ambition and over-ambition, and optimism and over-optimism (Haynes et al., 2015). Crossing the line into excess can ultimately bring about the demise of a promising business venture (Busenitz and Barney, 1997; Kramer, 2003).

If proof were needed of the precariousness and perilousness of business venturing, it is salutary to reflect on the failure rates amongst business start-ups. In the UK, it is estimated that more than half of new businesses fail to survive for longer than five years, and the picture is similar in the USA¹¹ (Figure 5.3). Even in spite of these high failure rates entrepreneurs are boldly optimistic. In a classic study from 1988 of 3000 entrepreneurs who were asked to rate their chances of success, 81 per cent saw their odds of success as 7 out of 10 or better, and a third, extraordinarily, saw their odds of success as 10 out of 10 (Cooper et al., 1988). Needless to say, the consequences of careless over-confidence can be financially catastrophic for individual entrepreneurs and investors, and in the bigger picture entrepreneurial hubris inflates venture failure rates and consumes resources (Townsend et al., 2010). However, as we shall see, hubristic incompetence borne of over-confidence may also have a bright side.

Building on earlier work in strategic management, researchers developed a ‘Hubris Theory of Entrepreneurship’ to show how over-confident entrepreneurs are more likely to initiate business ventures but also how such ventures are more likely to fail (Hayward et al., 2006). This research helps explain why entrepreneurs start their ventures in the first place when the objective chances of success are on the face of it discouraging. The answer – echoing the basic tenets of Roll’s Hubris Hypothesis – seems to be that *they think they know best*, and some of them, the successful and luckier ones, plainly do.

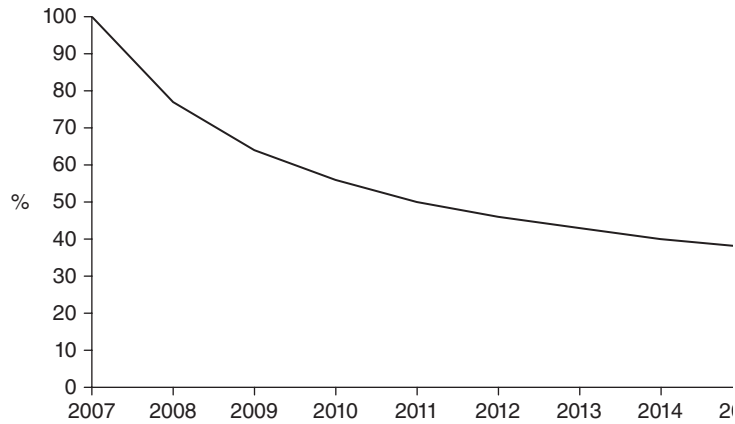


Figure 5.3 New business survival rates in the USA

Source: US Bureau of Labor Statistics at www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm. Reproduced by permission of US Bureau of Labor Statistics

Over-confident entrepreneurs not only ignore base rates but also choose to overlook the failure rate of competitors who have sought to exploit similar opportunities in the past, and under-estimate the strength of the competition (Hayward et al., 2006). They do so in the firm belief that with their abilities and talents – helped along perhaps by a ‘lucky hunch’ – they will be the ones to overcome the odds (Shane and Venkataraman, 2000: 220). The hazard faced by hubristic entrepreneurs is compounded by the fact that, counter-intuitively, people tend to under-estimate the difficulty of solving the more complex and dynamic problems which typify the business venturing environment (Hayward et al., 2006). Business venturers are at risk from a number of entrepreneurial hubris hazards, as identified by Hayward et al. (2010) (Table 5.6).

Table 5.6 Hubris hazards for entrepreneurs (Hayward et al., 2010)

Under-estimating challenges of complexity and dynamism	Hubristic business founders are likely to be most over-confident in environments with high levels of dynamism and complexity, and likely to be least over-confident when their tasks are neither complex nor dynamic
Privileging abstract business planning over the nuts and bolts of getting things done	Elaborate, high-level business plans are likely to render business founders more optimistic and confident about their ability to meet targets at the expense of completing business-critical tasks
Assuming what worked in the past will work in new venture	As new ventures become more dissimilar to prior ones, hubristic business founders risk exaggerating the extent to which the judgement and skills that they used before will work on new projects

Under-estimating resource requirements	Hubristic business founders are likely to start their ventures with smaller resource endowments and this increases the likelihood that their ventures will fail
Over-committing resources	Hubristic business founders are likely to commit greater resources to a new business opportunity and this increases the likelihood that their ventures will fail

In looking more closely into entrepreneurial hubris, researchers have drawn a distinction between entrepreneurs' expectations of their ability (a belief in their ability to perform certain actions) and their expectations of outcomes (a belief that actions will lead them to success) (Bandura, 1986; Townsend et al., 2010). Inflated expectations of outcome success can seduce individuals who may be both ill-prepared and ill-suited to the task at hand into starting new business ventures and failing subsequently. In addition to outcome expectations, entrepreneurs' ability expectations also play an important role in business venturing (Townsend et al., 2010). As well as over-estimating their chances of success, budding entrepreneurs tend to under-estimate the resource requirements of setting up a business and do not plan for foreseeable problems, thereby further amplifying the chances of failure (Wasserman, 2012).

Research into business start-ups in the USA suggested that entrepreneurs' beliefs in their abilities (ability expectations) was a stronger driver of entrepreneurial behaviour than their beliefs about the outcome (outcome expectations) (Townsend et al., 2010). In other words, it seems that they trust their abilities first and assume that successful outcomes will follow. In business start-ups, entrepreneurs' confidence in their ability appears to be the stronger driving force; if this is so then it may also be the greater danger. Perhaps hubristic entrepreneurs who challenge the odds know logically the chances of success (the likely outcomes) but have such faith in themselves (their perception of their abilities) that they choose to proceed and persist. The threat of hubris in small firms is amplified when business founders who overrate their abilities, are unjustifiably optimistic and run their firms more or less single-handedly, are not subject to the constraints of a board that can temper over-confidence by saying 'no' to reckless decisions (Wasserman, 2012).

LEARNING AND THE LESSONS OF OVER-CONFIDENCE

Failure is a fact of life in the entrepreneurial environment, however there may be a silver lining to the cloud of business venturing failure. The broader and longer-term effects of entrepreneurial failures are not entirely negative on two related counts: the view (1) that society needs over-confident, resilient risk takers; and (2) that there are lessons to be learned from failure in entrepreneurship as well as in all other walks of life.

Over-confidence may be a vital ingredient in taking business into unknown and risky territories where there will inevitably be, because of the nature of the terrain, causalities along the way. And, although hubris may be a factor that contributes to venture failure, the longer-term and broader systemic effects of high levels of confidence, ambition and optimism may be positive. Failure might help to build emotional, cognitive, social and financial resilience which better equips some individuals to rise again from the ashes to build a new or different venture.

Resilience is a second-order and longer-term benefit which overcomes the first-order and immediate costs associated with hubristic over-confidence and the failure of individual ventures (Hayward et al., 2006, 2010). Survivors of hubristic failure may go on to set up new businesses, achieve technology breakthroughs, develop new drugs, and so forth, which they may not have done had they not nosedived at some point along the way. Anecdotal support for the benefits of failure – encapsulated in Nietzsche’s aphorism ‘that which does not kill us, makes us stronger’¹² – is to be found in the well-known example of Thomas Edison (David, 1992; Hargadon and Douglas, 2001; Hayward et al., 2010). Edison is reputed to have completed more than 10,000 experiments, many of them failures, before he obtained any positive results in developing the first incandescent light bulb. Edison’s faith in his ability to achieve success was undiminished, and over the longer term the benefits of his optimism, confidence and ambition overwhelmed the costs of failure along the way (Hayward et al., 2010) (Table 5.7). Tales of well-known business resilience and bounce-back can be sources of inspiration for budding entrepreneurs, but given that such accounts are of exceptional outliers they may fuel an overly rosy optimism on the part of less well-gifted individuals (see Wasserman, 2012).

Table 5.7 Legendary entrepreneurial bounce-backs

Arianna Huffington	Rejected by 36 different book publishers before finally getting her second book accepted for publication. <i>Huffington Post</i> was founded in 2005 and panned by critics, largely for poor quality and limited potential. By 2011, the Huffington Post was receiving over a billion page views a year, and was purchased by AOL for \$315 million
Steve Jobs	Got ousted from his own company by John Sculley. Bought Pixar with the intention of developing it into a computer hardware company; it ended up evolving into an award-winning and profitable animation studio. Sold it to Disney for \$7.4 billion. NeXT computers failed. Returned to Apple with resounding success. Now one of the world’s biggest businesses
James Dyson	Made over 5000 failed prototypes before finding the right design for the bagless vacuum cleaner. Dyson had to rely on his partner’s income to stay afloat after his invention failed to gain traction in the British marketplace. Took it to Japan, where it was a success. Royalties helped fund a research facility and factory in England; unique bagless vacuum cleaners eventually gained worldwide success

Source: Inc magazine at www.inc.com/sujan-patel/5-failed-entrepreneurs-who-made-a-big-comeback.html (Accessed 9 March 2018)

The consequences of hubristic over-confidence, over-ambition and over-optimism are not unreservedly negative because they may, in the longer term, yield positive effects, especially in the turbulent venturing environments that entrepreneurs operate in and where recovery plans are in place (Hayward et al., 2006; Wasserman, 2012). For hubristic entrepreneurs driven on by confidence, ambition and optimism, failure can be not only a sobering experience but also, for those who are able and willing to make sense of it, a valuable teacher (Ucbasaran et al., 2013). However, a downside is that hubrists may not be inclined to the critical self-examination, self-regulation and reflexivity that learning from mistakes requires; they may impel themselves on a trajectory which reduces their chances of success and ultimately leads to unintended and unexpected failure (Hmieleski and Baron, 2008). This problem can be hampered by the fact that whilst business failures undoubtedly present opportunities to learn, failure is also a context which generates negative emotions and social costs which can inhibit our learning from mistakes (Shepherd, 2004; Ucbasaran et al., 2013).

Whilst a failed business venture is damaging for the individual concerned, the longer-term and system-wide effects of hubristic failures may not be unequivocally bad. For example, failure borne out of over-confidence can have potential benefits both for the individual and the system. Over-confidence can enhance entrepreneurs' self-efficacy by 'enabling them to feel good' about business venturing and achievement (Hayward et al., 2006: 170). It can also give them the 'wherewithal to move into risky territory' (Vecchio, 2003: 314). In this way, the ebullience, exuberance and energy of hubrism could actually be adaptive, albeit risky, in enabling entrepreneurs to deal with the high information-processing burdens in volatile and uncertain environments, in coping with the resultant stress and anxiety, and in promoting decisiveness (Hmieleski and Baron, 2008).

Entrepreneurial leaders must take considerable risks to be successful, and enthusiasm and confidence may also help founders to attract greater resources to the benefit of stakeholders and the wider society (Haynes et al., 2015; Hayward et al., 2006). The popular business press is replete with examples of confident, ambitious and optimistic leaders who have the courage and conviction to act on novel, risky projects that more risk-averse individuals might avoid, whereas timid, indecisive and defensive individuals will resist opportunity and therefore be unlikely to make the big breakthroughs that drive whole industries forward (Hayward et al., 2006). For example, when he was a teenager Michael Dell's grandiose aspiration was that he 'wanted to compete with IBM' (Hayward et al., 2006: 170). Dell learned from costly mistakes which made him less susceptible to hubris (Hayward, 2007). Dell also combined his ambition and resistance to hubris with a curiosity that has inspired him to continually seek out new ideas, keep pace with change and stay ahead of competitors.¹³

Conclusion

It is ironic that hubristically driven failure in entrepreneurship and business management more generally may be useful in that it can convey information about what might or might not work to other executives or business venturers who are then at liberty to either ignore the relevant information or resourcefully exploit it to their own advantage (Hayward et al., 2006). And, given that unrealistic optimism and the illusion of control are pervasive if people are ignorant of, or oblivious to, the chances of bad things happening, they may fail to take sensible steps to avoid negative outcomes (Langer, 1975; McKenna, 1993; Thaler and Sunstein, 2008; Weinstein, 1980; Weinstein and Klein, 1996). Consequently, if entrepreneurs or executives are running excess risks because of being overly optimistic or overly confident in their ability to control events, they are likely to benefit from board-level or policy-level interventions which re-calibrate their ambitions and expectations and push them in the right direction (Thaler and Sunstein, 2008). Executive toe-holders, advisors and vigilant, strong and independent boards, which are themselves actively monitored, are the linchpin in combatting the excesses of CEO hubris (Hambrick and Jackson, 2000; Heracleous and Luh Luh, 2002; Minichilli et al., 2007; Ranft and O'Neill, 2001).

Further Reading

- Nixon, M. (2016). *Pariahs: Hubris, reputation and organizational crises*. Faringdon: Libri.
- Sadler-Smith, E. (2016). Hubris in business and management research: A 30-year review of studies. In P. Garrard and G. Robinson (eds) *The intoxication of power: Interdisciplinary insights*. Basingstoke: Palgrave, pp. 39–74.

NOTES

1. <http://blogs.lse.ac.uk/behaviouralscience/2016/05/24/what-is-behavioural-science-at-the-lse> (Accessed 16 October 2017).
2. www.behaviouralinsights.co.uk (Accessed 16 October 2017).
3. For a discussion of the 'nudge' concept, see Thaler and Sunstein (2008).
4. www.theguardian.com/public-leaders-network/2015/jul/23/rise-nudge-unit-politicians-human-behaviour (Accessed 16 October 2017).
5. www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2017/thaler-facts.html (Accessed 22 October 2017).
6. www.national-lottery.co.uk/games/lotto/game-procedures (Accessed 2 November 2017).
7. Google Scholar citation metrics, 16 October 2017.

8. 'Whereas overconfidence relates to an overestimation of one's certainty regarding current "facts" (i.e. information), the illusion of control refers to an overestimation of one's skills and consequently his or her ability to cope with and predict future events' (Simon et al., 2000: 118).
9. <https://chiefexecutive.net/years-ceo-year-henry-scheins-stanley-bergman> (Accessed 17 October 2017).
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