

DILEMMA – INSIDER OR OUTSIDER DIRECTORS

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Abstract: *Achieving business success is becoming increasingly difficult, especially when viewed over prolonged period of time. However, some companies and their executive directors achieve positive results, while others remain at the level of mediocrity which eventually leads to their disappearance. It turns out that the success of the business is affected by whether the first people are appointed from within the company from the company, or those are outside people.*

Since this issue was not sufficiently addressed in the management literature, this paper attempts to shed light on this phenomenon from the perspective of the theory and practice of management. This paper investigates whether and to what extent insiders and outsiders affect business success, in order to translate the findings of this study for the implementation in the Republic of Serbia as a country in transition.

Keywords: CEO, insider, outsider, success

1. ARGUMENTS FOR AND AGAINST HIRING INSIDERS - OUTSIDERS

The dilemma regarding the leading people in the company, whether in leadership positions to set up someone from the company or outside the company, is a matter of judgment of owners (shareholders), i.e. what he wants to achieve with their appointment. There is no universal answer to this dilemma because each organization is unique, at different stages of the life cycle and often exposed to a variety of business and market competition. However, it is possible to point to specific situations in which priority is given to either insiders or outsiders.

The dilemma insiders or outsiders must be solved by the policy which is formulated by the owners of the company. Practice shows that insiders are generally appointed when there is a high quality human resources, or individuals or experts that have proven their ability in the company, doing a variety of jobs in different functional areas. In these circumstances, the board or the owners have a clear career plan for development of management structures. In the event that the executive director or other executives leave the company, owners do have options, i.e. they do have at their disposal individuals who may be able to take over management of the company, or some functional part of the company. Career plan is commonplace in large business organizations, but there has been certain criticism regarding this issue. The most serious criticism states that planning a career does not stimulate the competitive spirit and competition of individuals in advance to favor individuals, since it is known in advance who will take the top position. In order to eliminate

this problem, some companies are preparing more candidates for these places, and they are usually appointed deputy director-general. However, practice shows that here we have an even bigger problem between rivals on the one hand, and employee relations. It turns out that today employees too are asked for their opinion on the appointment of top people. Wise owners will never appoint competent individuals if they are not accepted by the executive structure, throughout depth and width of the organization. This often becomes the deciding factor in the appointment of individuals, which is only natural because today there is a need for a high level of socialization and appreciation of the personality of every person by the top management [1]. Another factor that goes in favor of insiders is an attempt to ensure the continuity of the organization, or the completion of certain tasks. It turns out that in the modern business we establish cooperation primarily with people, and then with the organization. In these circumstances, it is not wise to change the management structure, and in particular the first man since the arrival of a new man and even his deputy, often changes relationship between the partners, and often leads to the further co-operation with individual companies. In other words, companies in business relationships get associated with personality and individuals, so that even if there is departure of an individual, they usually continue to cooperate with the company in which the individual was engaged.

Of course, the family company has leading positions typically reserved for a family member or founder. It is usually the oldest or the most experienced member of the family who is at the same time both visionary and strategist. In the family or in the company where there are family relationships outsiders have no chance. It is important to point this out because there are authors who deny the specificity of a family business. They ignore the emotional connections and relationships between family members that are at the same time the strongest cohesive tissue of integration of all members towards achieving the set goals. Any exclusion of emotion and effort to the relationship between family members is reduced to interpersonal and business relationships not only is unacceptable but impossible, and it is also detrimental to business success. It turns out that a man is willing to sacrifice himself only for his descendants, and that through good family relationships one can build a successful business and, vice versa, a successful business encourages the creation of good family relations [2].

Outsiders have more chances in companies that do not have enough qualified staff. Here the owners feel that there is a sufficient number of educated people for office business in the market, as well as for strategic management, and that there is no need to prepare and plan their own leadership potential. In this context, the company hires the so-called 'head hunters,' i.e. agencies, consultants and other parties to make recommendations for the appointment of the first people company. These professional organizations keep records of successful managers ranked their success and are able to recommend appropriate strategic managers, keeping in mind whether you are talking about intellectual, manual, dynamic or classical organization. Another element in favor of outsiders is when we want to break the continuity of certain trends, i.e. we want a clear break with current practice in companies. The owners recognize that certain strategies do not provide satisfactory growth and development, and competitiveness and profitability. These are often high costs, lack of flexibility, solid bureaucracy of the organization, and so on. In these circumstances, the owners are trying to bring a new leading people, or people with new ideas, approaches and philosophy of business. This is similar to changing the sports coach when the team does

not achieve the expected results. By bringing a new coach we are changing the attitude of the team, but also within other parts of the sporting organizations, thus with the same team we achieve better results.

An outsider is often the solution when we have disturbed interpersonal relationships within the organization. This is so whether it is the case of disturbed relations between people or between parts of the company and between the company and the environment in which it operates. Shareholders or owners feel that there is no authority in the organization that could solve these problems and make decisions to invite an outside person.

2. ADVANTAGES AND DISADVANTAGES OF INSIDERS AND OUTSIDERS

Appointment or selection of strategic managers is the most important task of management or board of directors or shareholders assembly. Errors in this regard are being paid dearly, which requires high professionalism in the selection or appointment of the Director. Some companies, as noted, do plan a business career and prepare individuals for senior positions, while others choose to hire professionals to manage the side. Notwithstanding the foregoing, any dismissal of the head of the company causes tentative “shocks” and is often reflected in the decline in stock prices, which can lead the organization in a very difficult situation. Hence the practice in many companies that the health status of top managers or possible illness is kept as a secret because when stakeholders get hold of this information about diseases of the Director whom they believe, this leads to lowering the price of shares, and thus the sales price of the company [3].

The involvement of an insider or an outsider has its good and bad sides. The good sides of insiders are generally poor by outsiders. However, things are much more complicated. It may be noted that the rule is that there are no strict rules or correct answers. We should particularly keep this in mind now. This is a time of revolutionary change and great uncertainty that requires strategic management to be adaptive and to provide fast and high-quality answers to increasingly complex and interrelated problems.

However, the practice has differentiated good and bad sides of insider or the outsider appointment of the first people company, which is relatively well represented in the following table: Advantages and disadvantages of insiders and outsiders can be strengthened or reduced, depending on the type, size and type of organization. For example, in case of intellectual organization, election of the first man is much more complex, as compared to an organization followed by manual structure. However, each organization is distinct and unique, so that the weakness of one can be strengths in other organizations. The above indicates the need for a broader explanation of the above table.

2.1. Advantages and disadvantages of insider directors

Although it is difficult to generalize insider and outsider directors on the criterion of business success, it is shown that insiders have their strengths and weaknesses, which can be represented by the following arguments:

Table 1: Advantages and disadvantages of insider (outsider) appointments of leaders in companies

<i>Advantages</i>	<i>Disadvantages</i>
<i>Insiders</i>	
<i>Better knowledge of the problem</i> <i>Better knowledge of the org. resources</i> <i>Knowledge of the org. culture and relationships</i> <i>more committed to the company</i> <i>Employees can influence the selection of managers</i>	<i>The ability to create</i> <i>Favors unit where it came from</i> <i>Not ready for radical change</i> <i>Do not have sufficient authority</i> <i>Accustomed to the current state</i>
<i>Outsiders</i>	
<i>Generalizes different experiences</i> <i>New people bring new ideas</i> <i>Objective interest in making decisions</i> <i>Faster running organizational change</i> <i>The involvement of professional organizations</i>	<i>Inadequate knowledge of the problem</i> <i>Not familiar with relationships in the organization</i> <i>Longer time to adapt to the organization</i> <i>Mechanical transmission of past experience</i> <i>Increased costs in seeking outsiders</i>

a) Insiders' advantages

- They are more familiar with the problems of organizations. This is the most powerful insider feature because people often live with the problems of the organization and can relatively quickly diagnose its causes, and hire a specialist or agency to resolve the problem. Insiders often understand and solve the problem, and often can be with their own staff to the same resolve, reducing time and costs, which in modern terms is increasingly gaining in importance.
- Insider directors have deeper knowledge of organizational resources. People in the organization know each other and know their abilities, and strengths and weaknesses and are able to design their outcomes in appointments to senior positions. Wise insiders are more opportunities to seek ideas within the organization. According to many, "local" ideas have much more credibility than those who came "from outside". This is particularly evident when rewarding individuals or departments, or departments within companies that innovate, or to stand out. [4]
- He is familiar with the organizational culture and interpersonal relationships. Organizational culture and behavior are very important factors of business success. Insiders usually do not need to adapt to a particular organizational milieu, nor the organization to adapt insider director. In this context the knowledge of interpersonal relationships and creating opportunities to eliminate the causes that aggravate relations between people, enhancing the powers that enhance interpersonal relationships.
- Insider directors are more committed to the company. Individuals are often associated with the company and are willing to stay the same, even when there is a problem. When the organization is in a difficult situation, an insider CEO is often the only solution because outsiders often do not want to take responsibility for a bad company.
- Employees may react to the appointment. Sometimes they can have a decisive influence on the choice of insider directors. This particularly applies to those who have shown leadership positions in organizations and that employees believe, and whom

they trust. It shows the confidence today most vulnerable to the phenomenon of micro-level (individual level), and also at the organization level, i.e. at the macro level.

b) Disadvantages of insider directors

- Many years of work in an organization create bonds of friendship that can weaken the organization, especially when the friendship abused. Friendship and friendly relations can be both strong side, because the people in the name of friendship are able to make more sacrifices for the common goals. However, the example of Serbia and other countries in transition shows that friendship is often misused and that is one of the main reasons of unprofessional management.
- He favors organizational unit where it came from. The largest number of insiders can never rise above the workplace and organizational unit where he was. For example, if a man of finance is appointed to the position of top management, he primarily deals with financial matter even though he is now the CEO. More often than not, he usually simply returns to his 'flock.' Of course, this can be a problem because it creates unequal status of men or unequal status of parts within the organization, which undermines its homogeneity and the ability to act integrally.
- Insider director is not ready for radical change. The downside is the administrative proportion to the length of service of the individual in the organization, as well as with age. We see that individuals who have more time in the organization, as well as older people are not ready for radical change. They are difficult to change and very restrictive accept new ideas, trying to work the old way.
- Strategic managers who come from the organizations do not have the authority, especially if they had spent considerable time in the organization. For many, the newly appointed Managing Director of the organization will remain the same person as when he occupied some lower management position. This usually applies when an insider director asks for gaining certain knowledge or university degrees, including PhDs. Many directors are not able to think strategically, deal with trivial matters and are not ready to respond to new challenges.
- Insider directors can often be inert and insensitive to certain negative developments in the organization. Habits often produce inertia to change a bad situation, so that the problem is ignored. For example, insider directors in a Serbian company were not interested for years to do an analysis of the cost of each line and each public transport vehicle. This should have served to review the costs, i.e. to get a clear picture of how much money they must feed into this 'dragon' in order to make the business process profitable.

From the above it can be concluded that insiders have good and bad qualities, and that it depends on the personality of each individual. Practice shows that a manager who had not change a company at least, is actually not a manager at all. Business history has repeatedly shown examples of top managers who have been raised in a certain company and spent their entire lifetime there, but still they did experience difficult times and challenges.

2.2. Advantages and disadvantages of outsiders

Outsider directors have gained in importance in the second half of the last century, when increased competition and when the owners, with their own human potential have not

been able to meet the new challenges that have appeared in the business sphere. It turned out that the cause of problems for many organizations was excessive orientation to their own staff, which made organization closed and not capable enough to learn from others and through other people and organizations. In this context outsiders have become one of the ways to increase competitive advantage. Analysis of engagement of outsider director shows the following pros and cons:

c) Advantages of outsiders:

- Outsider director generalizes the experience of other organizations and used by them in their work. Potential outsiders are often people change companies, or go from company to company, they acquire different experiences and are able to generalize and apply in their work to other companies. Of course, it should be borne in mind that each organization is unique and that the transfer of solutions from one organization can produce different and often conflicting results.
- New people bring new ideas. The organization often is faced with crisis due to the application of the same concepts over a longer period, or the application of the approaches that are outdated and as such unacceptable. In other words, individuals who have led the company in a difficult situation, they are unable to get out of the same situation, because the problem resulting from the application of inadequate concepts. In these circumstances, the solution is to bring outsider directors, who need to bring not only new ideas, but also refreshing attitude and optimism.
- Outsider director is more objective in making decisions related to certain interests. New, outsider director is not burdened by certain relations, friendly relations and influences and is able to make more objective, and rational decisions. For example, when it comes to the preparation of lists of redundancies, outsider director makes a just decision, while the insider is often taken to protect his friends, so to speak.
- Outsider director is able to quickly bring radical change. Related to this, let us mention the fact that outsider directors are able to perform faster change, especially if it is a radical and un popular change. It's important to establish a rapid diagnosis of the current situation and create sufficient critical mass to implement changes. If an outsider director is delaying the execution of change, his willingness to introduce the changes will become more "dull." There is also a danger that individuals who are against the change will become stronger and create coalitions that seek to maintain the status quo.
- Hiring or appointing an outsider in market countries is usually accompanied by the professional recommendations of expert agencies, companies and consultants. They have the data and characteristics of potential individuals in the previous results, or results in other companies. Agencies evaluate and analyze the specific organization and based on that recommended expert who could successfully take control. If the organization is in crisis conditions (i.e. losing market share and customers, employees leave the company, poor interpersonal relationships), we recommend an outsider who respond quickly to problems that have practical solutions and has the tact in dealing with people. In these circumstances, it is not likely that the recommendation is inadequate.

d) Disadvantages of outsider Directors

- He does not know the business problem. This is particularly evident if an outsider director comes out of existing branches where there are different bases of functioning and characteristics. For example, when coming from an agrarian to an industrial company, it is unlikely that the experience gained in previous operations will be of great benefit, because each activity has a number of characteristics in management. A special danger is outsider directors who want to do their job, but do not know how to do it; all this boils down to the familiar folk wisdom: "The ignorance in action is the most dangerous thing."
- Outsider director does not know the human potential. Outsider before coming to a particular company will first check human potential through insider that exist in the company, but also by our competition, business partners, and even the specific agencies involved in this work. However, outsider should have a "seventh sense" to assess the qualitative side of the staff, their emotional and motivational potential and characteristics. Of course, he should in a relatively short period of time select his team, and the people who do possess special knowledge, skills and abilities.
- It takes longer for an outsider to fit into the existing milieu, or to modify it. Arrival of each individual in the new environment is a stressful event for both the one who is coming, and for those in whose organization the individual comes. When it comes to the outsider director, stress objectively exists with people in his environment, because there is fear that the individuals do not fit into his system of work, or the outsider director does not fit into the existing operation and general business philosophy.
- Using the experience from previous work can prove wrong. It turns out that outsider director can mechanically transmit the experience of management in the early, or earlier organizations, which are at the same time is unacceptable, considering that each organization has its specifics and particularities. For example, if the experience of small business is transferred to large commercial systems, it can be not only ineffective, but also counterproductive.
- Cost and time of the appointment are increased, or extended. Experience shows that owners often turn to specialized agencies that would have to recommend appropriate Directors for controlling the organization. In this context, agencies typically require the analysis of organizational performance with regard to quality of staff, the organic composition of capital, whether it is on a manual, or intellectual organization, in which the age of organizations, whether and how successful, and so on. It is necessary to allocate significant funds for the election of directors, but also takes time, which can be a big problem for stakeholders.

Analysis of the strengths and weaknesses of insiders and outsiders should be entrusted to multi-disciplinary teams. The most important thing is to diagnose the state of the organization, because it is possible that professional bodies (agencies) or owners (employees) due to poor diagnostic recommend wrong solutions, or people who need to ensure survival, and growth and development of the organization. Good or bad results in previous organizations are not a guarantee that these results will automatically be replicated in other organizations, and even in the same organization at different times.

3. INSIDERS – OUTSIDERS IN DEVELOPED COUNTRIES

The fact is that there are different criteria by which to evaluate the success of the business of the general manager or executive director, president, etc. It turns out that most often as criterion of business success we take profitability, and share price growth from the time of taking the company to the end of his term. This classic criterion has a high level of correlation with customer satisfaction and other stakeholders. However, in the last decade as a criterion of success of business leaders to take the fact the condition is a director of the company, took over from his predecessor, and how the company works after the departure of its leader [5]. The theory and practice of management is based on the fact that outsiders are more objective because they come from outside, or from other companies and are able to make better decisions. Furthermore, the outsiders generalize experiences gained in other companies and can better apply them to a particular organization. According to many theorists, outsiders are often the only solution when the company is in a crisis situation and when it is uncertain that the management that led the company into the very difficult situation can perform consolidation, revive the company and move it towards prosperity. This view was taken from professional sport, where in the event of disturbed interpersonal relationships and failures they engage people outside the club, which will consolidate the ranks and have put in a position to achieve better results. This statement is confirmed on the example of top managers. Among the analyzed fifty most successful executive directors, the outsider solution proved to be successful in the case of the Executive Director placed as number 19, John Thompson, who had left a job at IBM to take over the CEO of Symantec which was in a very difficult situation [6]. However, the Harvard Business School and other management researchers are of the opinion that insider managers are better option (for the position of CEO). They argue that outsiders are expensive and that's critical in this mode; they do not know the specifics of the same company in the above research showed that though insiders showed better results. Within 2000 companies insiders have had a better position in 57 companies, more than outsiders. The companies that were in trouble were more likely to hire outsiders as CEOs, which corresponds to the claim that directors who have led the company in a difficult situation not being able to get away from the same situation. However, when we compare the CEO who took over companies that operate poorly, outsiders did not achieve a better result by whistleblowers. Finally, of the five most successful leaders who have been the most successful since the mid- nineties, they all came from the company, or were insiders. This research has shown that on the list of fifty most successful executive director of the world in 76 % of the cases are those who have been raised in their company and in the same used to perform certain tasks, such as finance, development, human resources, etc. Steve Jobs, the most successful man in the business world, grew as Apple executive, first as an acting board member and then as executive officer (CEO). After Jobs died, he was replaced by Tim Cook, again the man from Apple, who worked together with Jobs and Jobs had had confidence in him [7]. The situation is similar with other names in the group of 50 of the world 's most successful executive directors. Most insiders, before they come to the top positions, were engaged on the average in two companies in important positions for some 5-8 years. Thus, the gradual progression in career is one of the most important principles of creating a successful manager. The companies plan and develop the careers of their managers and executive directors. Search and selection for the chief executive has

become a very challenging job, requiring competence, multidisciplinary skills, and art. The advantage of an insider is in better understanding of the problem and the situation in the company, and he can often motivate capable and loyal people from the company, but they have the problem of subjectivity in decision -making in particular interest cases. However, this weakness can be relatively easily remedied, because when individuals reach the top position, they must learn to forget what they had learned before, etc.. All this is very difficult, but not impossible.

4. INSIDER OR OUTSIDER IN SERBIA

The issue of insider or outsider appointment or election of directors is not considered in the management of Serbia. This does not mean that this factor has no effect on the business performance of Serbian companies,. In the above should be noted that Serbia is a country that is still doubtful about management as profession and management is presented in a negative light. It is often pointed out that we educate a large number of unnecessary future managers who can not find jobs. The situation is completely opposite. Serbia lacks over 100,000 managers of different levels of management (top management, middle and lower management) in different areas of life and work. Those are pre-school institutions, university facilities, medical, cultural and business organizations. All this in the following sectors: industry, agriculture, mining, tourism, all the way to the public administration. The most important positions in the public sector, which accounts for over 50% of the Serbian economy, is occupied by incompetent people. In other words, instead of professionalization of management in Serbia there is ideological and cheap political management. Its main task is not to ensure the success of a business organization, but to provide privileges to a certain political option, which appointed him to that position. Hence the dilemma between insiders and outsiders does not appear in a serious form. There is a debate on the professionalization of management in all areas of the economy and society. [8]

The dilemma insider or outsider is conditioned on the type of ownership. In private, especially family businesses, the rule is to appointed individuals from the organization, or the insiders to leading positions. In a family business that is usually a member of the immediate or extended family, or individuals who have been checked. In SOEs mainly the system of out- sider nomination and the political structure that is in power is applied.

However, it can be concluded that in most organizations there is no career planning and advancement of people from the company. The reason is that management is still perceived as a profession and as a craft that requires a certain competence, knowledge and skills. Accordingly, management is not seen as a permanent profession, but as a temporary and occasional management of organizations.

Although there are no precise figures, it is estimated that Serbian companies prefer outsider directors, especially when dealing with large organizations that exist in the public sector. Here the directors change when the party in power changes. This means that directors in large public companies tend to retain about three years, and the time interval when the Serbian conduct elections at all levels of the change of power, even when the same political options remains in power after the elections, there shall be the appointment of a new Director. Outsider appointment of the leading people in companies in the public sector, who are both incompetent and inexperienced, but party officials leads to bad results in business. According to the data, in Belgrade in 2012 there were 26 public companies

which, employ about 18,000 employees. In these companies the total income in 2012 was around 68.3 billion RSD, which amounts to about 600 million euros. The highest income was recorded in Belgrade Electricity Co. with almost 30% of total revenue, at least was recorded by the Olimp Sports Center, about 50 million RSD, or half a million euros.

Of this number of public companies, 8 companies in 2012 reported a loss of around three billion dinars, or about 300 million, while other public companies working with minimal, or no gain. The greatest loss is expressed Public Transport Company in an amount of about 2 milliard dinars, or about 200 million euros. In most of the Belgrade public companies, directors are appointed by the party's key and largely as outsiders, often with no working experience and competence. A similar situation arose in recent years [9].

In these circumstances, better result was not to be expected. This necessitates a radical redesigning of public sector Serbia so that instead of party cadres and outsider (who are appointed temporarily and periodically) to introduce those who have graduated from a manager and experience in managing an organization. Of course, the practice of the developed world should be implemented in Serbia, meaning that primarily insiders should be appointed, including career planning and long-term preparation of personnel to down-load the most important positions in organizations.

Serbia has thousands of graduate managers, who may be appointed to leading positions in the public sector, government agencies and organizations, health, educated, cultural and other institutions and agencies. Their places are now occupied by political, incompetent people. De-politicization of the public sector in terms of management is the first step in the reform of the political scene in Serbia announced more than a decade and a half ago.

5. CONCLUSION

The issue of insider, i.e. outsider directors is not sufficiently clarified in the theory and practice of management. Analysis has shown that this issue is the high level of correlation with business success rate, i.e. the most successful global companies appointed directors of the company, with career plans of each manager and his progress. In other words, companies monitor individuals in lower management positions, monitor their performance and improve them gradually, until they are ready to occupy a certain position with high responsibility. This practice is natural, because the management company is one of the most complex activities which one can engage. Hence the above practice of selection and election or appointment of directors. This is because the error in his choice of paying expensive and often difficult to correct all the turbulent and uncertain market.

In Serbia, a country in transition, the practice is quite different. In over 75% of companies in the public sector managerial positions are reserved for people from the party or coalition in power. They are named as outsiders, at intervals when local or parliamentary elections are held. Therefore, it is noted that the director's position in Serbia is provisional and temporary, and that this complex and very hard profession is occupied by the incompetent, inexperienced amateurs. Outsider directors, as second-rate, surround themselves with the party aides and advisers (who are third-rate personnel). These people continue to surround themselves with the fourth rate associates and thus create negative pyramid of personnel. Outsider directors in Serbia are generally loyal to their party. They generally provide privileges to the party in power, and are not interested in the business perfor-

mance of the companies they manage. After the expiry of the mandate, the leave for other party duties, and as party officials they implement the policy of their party.

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