

*(ANDRE P.) Discussion of Firm Performance and Managerial Succession in Family Managed Firms, Journal of Business Finance and Accounting, Vol. 36, No. 3, 2009, pp. 485-495.*

### **New CEO, better performance?**

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In this article, I survey research from the last five decades into the causes and results of CEO turnover at listed companies, highlighting researchers' key findings and the difficulties that they face in drawing clear conclusions.

When looking at CEO turnover, we have to distinguish between forced and unforced departures. Being fired is the single cause of forced departure, but unforced departure may happen because of retirement, resignation or even death. Sometimes, firms prefer not to disclose the reasons for a CEO leaving in great detail, which makes analysis harder. Most researchers exclude CEOs who die in service from their research, but retirement is a grey area – retirement ages vary, and the age of a CEO seems to be a significant factor in CEO turnover.

How many CEO departures are forced? UK academics David Hillier and Patrick McColgan recently found that 34% of 494 departures analysed were forced. This is a much higher proportion than US researchers have found, with other estimates ranging from 13% to 24%. However, each study looks at different countries, industries and time periods; CEO turnover tends to be higher in periods there are more company mergers and acquisitions. We know little about the case of CEOs who also serve as Chair of their firm relinquishing the CEO role and becoming simply the Chair. This is a potential area for future study.

The nature of the firm and its current situation have an important bearing on CEO turnover, but analyzing this relationship throws up a number of issues.

Many studies have found that CEOs are more likely to be replaced when the firm's performance is poor, as we might expect. However, the measures used to evaluate 'performance' are not fixed, which makes comparisons difficult. Sometimes, the measures to be used are stipulated in the CEO's contract. Several researchers have found that missing EPS growth targets, which are often used by financial analysts to discuss a firm's prospects publicly, is a good predictor of CEO turnover.

Another issue is sample selection. For example, should we include CEOs who lose their jobs if their firm is taken over or goes bankrupt? Very few CEOs survive a takeover – only around 17% keep their role, and two-thirds of those are gone within three years. But it is a challenge for researchers to isolate this subset of forced CEO departures, since the link between a takeover and a CEO's departure may not be clear or immediate.

Large and/or older firms are more likely to replace their CEO, but researchers have found it hard to explain why. The problem here is that a larger firm often has other attributes, such as complexity or bureaucratization, that may also affect CEO turnover – again, it is difficult to isolate the real causes.

The industry in which a firm operates also seems to have an impact. If there are lots of similar firms in a sector, CEO turnover may be more likely because it is easier to assess the CEO's performance relative to their peers – and find a suitable 'like for like' replacement.

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Governance, or the way a firm is run, is critical. In 1990, Fazel and Louie suggested that it could be even more influential than performance on CEO turnover. More independent boards – those that include more part-time or non-executive directors – are more likely to sack CEOs, but it is hard to measure independence. On the other side of the coin is the CEO's power, which may be based in stock ownership, long service or being the Chair. A CEO who owns more stock is more powerful and entrenched, and even a small stake in the company seems to make it less likely that a CEO will be fired. However, we could also argue that a stake motivates the CEO to stay on and remedy poor performance.

This raises the broader question of ownership. Some firms have majority shareholders (often founding families) who own large blocks of shares, sometimes with enhanced voting rights. Recent research has found that big family stakes in public companies are more common than previously believed. Large blockholders sometimes look after their own interests before those of the firm, for example by awarding special dividends. Also, because their investment is concentrated in one firm, they may be more risk-averse than other investors. This may result in managerial entrenchment – for instance, if the owners of a family firm resist appointing professional managers from outside the firm.

For analysis purposes, most researchers adopt a distinction between owner-controlled firms (managers own most shares), externally controlled firms (outsiders own most shares) and management-controlled firms (share ownership is widely distributed). Generally, the more power managers have (through share ownership), the less likely CEO turnover is. Often, CEOs in owner-controlled firms can even weather poor financial performance and retain their positions.

Informally, we might describe firms that are majority owned and controlled by the founder's family as 'family firms', but defining them this way is problematic. Founders often retain a majority shareholding, as Bill Gates has done, but is Microsoft really a family firm? Founder-run firms are interesting in the context of CEO turnover, since founders often step aside for new CEOs at critical points in their company's development, such as completing key projects or refinancing. But separating family and non-family CEOs turns out to be quite challenging. For example, looking for shared surnames risks missing in-law relations. It is also difficult to determine the level of a family's shareholding if it is shared between several family members.

Does changing CEO improve performance? Common sense suggests that firms replace CEOs to improve performance, but disruptive changes in difficult times can make things worse. It may even be that some sacked CEOs are just scapegoats – replaced to give an impression of something being done about poor performance. Researchers looking at the stock market's reactions to CEO turnover have found mixed results, but it is very difficult to isolate the effect of the CEO change from other factors. We have a way to go before we fully understand the relationship between founders' or CEOs' departures and the fortunes of the firms they leave behind.