Journal of Business Research 66 (2013) 2466–2472

Contents lists available at ScienceDirect

Journal of Business Research

CEO turnover and shareholder wealth: Evidence from CEO power in Taiwan ☆

Hsiu-I Ting *

National Kaohsiung First University of Science and Technology, Taiwan

ARTICLE INFO

Article history:
Received 1 September 2011
Received in revised form 1 October 2012
Accepted 1 February 2013
Available online 18 June 2013

Keywords:
Turnovers
CEO power
Announcement effect
Shareholder wealth
Volatility
Liquidity

ABSTRACT

This paper investigates the relationship between CEO turnovers and shareholder wealth and/or the volatility of firm performance, and examines whether CEO power matters in this relationship. Successors tend to possess less power than predecessors. The announcement effects of CEO turnovers present higher abnormal returns for turnovers in which predecessors and successors share a similar power level and a lower volatility for turnovers in which successors have less power. Volatility is lower and liquidity is higher when CEO turnovers involve successors with less power.

© 2013 Elsevier Inc. All rights reserved.

1. Introduction

> *Apple Inc. CEO Steve Jobs, who built the world's most valuable technology company, resigned. He is succeeded by COO Tim Cook.*
> [*Bloomberg, August 24, 2011*]

Apple shares fell as much as 7% in extended trading after the announcement of the resignation of Jobs who has been a strong figure in the company historically. Several studies attempt to investigate the impact of CEO power and CEO turnovers on firm performance and/or risk, respectively. This paper integrates the above two issues by assessing the relationship between CEO turnovers and shareholder wealth and/or the volatility and by examining whether CEO power plays a role in this relationship.

Daily and Johnson (1997) test the interrelationship of CEO power and firm financial performance. Adams, Almedia, and Ferreira (2005) investigate whether firms experience more variability in performance when CEOs have more power. Harjoto and Jo (2009) examine the effect of CEO power on firm performance from life-cycle theory. This paper considers the influence of CEO power shifts. Huson, Parrino, and Starks (2001) find a rather consistent relationship between the likelihood of forced CEO turnover and firm performance. DeFond and Hung (2004) find that strong law enforcement institutions improve the association between CEO turnover and poor performance. Both studies focus on CEO turnover-performance sensitivity rather than focusing on the CEO power shifts due to CEO turnovers. Allgood and Farrell (2000) study CEO tenure, firm performance, and forced turnover, but rather than focusing on dynamic CEO power and its impact on shareholder wealth and/or volatility, they focus on the effect of CEO power on performance-forced turnover relation.

This paper has three purposes. First, it analyzes the dynamic of CEO power from turnovers. The underlying idea is that firms might prefer a certain CEO power-shifted turnover type. According to the circulation model, CEOs with less power are expected to be cautious when consolidating their current positions. The directors may be apt to nominate CEOs with less power. The result shows that approximately 87% of successors in CEO turnover events have less power.

Second, the paper studies the market reactions to turnovers with regard to power shifts. Applying the view of the circulation theory, I expect that investors have more confidence in a firm whose CEO power level is relatively stable. I find positive effects of the overall turnover. The positive effect is driven by symmetric CEO turnovers and supports the common sense theory which indicates a positive reaction after CEO successions. I do not find significant announcement effects of turnovers involving CEO power shifts — consistent with the ritual scapegoating theory that suggests an insignificant relationship between CEO turnover and firm performance.

The paper finally investigates the effect of a CEO power shift in the relationship of CEO turnover and investment risk. Adams et al. (2005) find that stock returns are more variable for firms run by powerful CEOs. Hence, I anticipate that successors with less power may contribute to lower risk and higher liquidity. The variability of stock prices decreases after the announcement of the overall CEO turnovers. Moreover, volatility is lower and liquidity is higher when CEO

☆ The author thanks Horace Chueh and Pang-Ru Chang for the helpful comments on previous versions of this paper.

* No 2, Juoyue Rd., Kaohsiung City 81164, Taiwan, ROC.
E-mail address: hiting@nkfust.edu.tw.

0148-2963/$ – see front matter © 2013 Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.jbusres.2013.05.036

turnovers involve successors with less power. The results are robust to include alternative measures, the possible influence of informativeness, and the prolonged event windows.

This study contributes to the existing literature on CEO power and turnovers in two important ways. Little research has been done on a direct empirical assessment of the announcement effect of CEO turnover regarding the power shift. This study examines the informational effect of CEO turnover as reflected in different types of CEO power shift. I add to a small but growing literature that examines CEO turnover outside of the United States. Developed markets are characterized by strong legal protection of minority shareholders' interests and diffuse ownership structures. Emerging markets such as Taiwan are characterized by weak protection of shareholder and creditor rights. The prevalence of family businesses in Taiwan (about 70% of listed companies are this type) increases the power of the strategic decision of a business owner. CEO succession is an important issue in such an environment since the CEO is a key element in the managerial decision and plays a major role in the functioning of organizational strategies.

According to agency theory, CEOs are self-interested, risk averse, and possess goals that diverge from those of shareholders. Thus, CEOs will engage in self-serving actions at shareholders' expense when given an opportunity (Jensen & Meckling, 1976). This paper broadens the knowledge by showing that a CEO power shift plays a role in the relationship between CEO turnovers and shareholder wealth and/or volatility. This result provides evidence for the existing CEO turnover literature and thus has important CEO succession implications.

The remainder of this paper proceeds as follows. Section 2 discusses the related theory and proposes hypotheses. Section 3 describes the sample and methodology. Section 4 represents the announcement effect of CEO turnovers regarding CEO power shift and the influence of different CEO turnover types on volatility and liquidity. Section 5 provides a conclusion.

2. Literature review

According to the circulation model, Ocasio (1994) argues that long-tenured CEOs increase their technical and political obsolescence and are less likely to undertake significant organizational change. As the firm performs badly, latent conflicts may come to the foreground, and the CEO's power may be threatened. Accordingly, CEOs with less power are expected to be cautious to consolidate their current positions in the organizations. This paper predicts that directors may be apt to nominate CEOs with less power to avoid the higher chance of powerful CEOs' strategies being unable to match environmental contingencies, and furthermore investors may prefer relatively prudent power shifts. The dynamic of a CEO power shift will probably affect the stock returns after the announcement. To apply the view of the circulation model, this paper proposes the following hypothesis.

Hypothesis 1. The effect of CEO turnovers is positive when the turnovers involve predecessors and successors with a similar level of power.

Three important theories are proposed to illustrate the impact of executive turnovers on firm performance: common sense, vicious circle, and ritual scapegoating theory. These theories are supported by the literature from different perspectives, which may provide alternative explanations for different types of CEO power shifts. First, based on the common sense theory, the reasons for CEO turnovers could be involuntary or voluntary. When the directors select a nominee for CEO, their major concerns are business experiences and professional backgrounds that could promote firm performance and maximize shareholder interests. Thus, the successor of a top manager could improve firm value. The findings of Helmich (1974) and Furtado and Rozeff (1987) support the theory.

Second, the probability of CEO turnover will be high when the firm performs poorly. Grusky (1963) argues that a successor may be unfamiliar with the firm's business culture, and firm performance could be worse due to tense and split internal relations. Accordingly, the vicious circle continues and consequently the stock price declines. The empirical studies conducted by Beatty and Zajac (1987) and Suchard, Singh, and Barr (2001) support this view.

Third, Gamson and Scotch (1964) select subjects from 20 major league baseball teams and find that the turnover frequency of a team's coach is relatively high when the team performed worse. Ritual scapegoating theory indicates that a manager fired by the firm is merely a victim of prior poor performance. Thus, the relationship between CEO turnover and firm performance is indistinct. Eitzen and Yetman (1972) use the records of college basketball teams and conclude that coaching shifts do not affect performance. Consistent with the ritual scapegoating theory, a change in managers makes no difference in organizational effectiveness.

These contradictory arguments suggest that the relationship between managerial turnovers and shareholder wealth may not be universal, as most previous studies have assumed. Some research studies have started to focus on the discussion of the influence of powerful CEOs. Dunn (2004) proposes that CEOs may use their power to fulfill self-interests at the expense of shareholder wealth, and this may result in the agency problem. On the contrary, some studies conclude that powerful CEOs could help the firm out from distress by their cumulative experience and knowledge. Adams et al. (2005) suggest that firms with powerful CEOs are not only those with the worst performances, but also those with the best performances. This paper suggests that the announcement effect of CEO turnovers on stock returns depends on the power shift from predecessors and successors. Since inconsistent results are observed from the previous studies, to what extent and in what way do investors react to power shifts remain open empirical questions. This paper examines three potential effects of CEO turnovers on stock returns based on the following hypotheses.

Hypothesis 2a. In terms of the common sense theory, the returns increase and the volatility of returns decreases for CEO turnover since the major concerns when selecting a CEO are business experiences and professional backgrounds that could promote firm performance and maximize shareholder interests.

Hypothesis 2b. In terms of the ritual scapegoating theory, a predecessor is merely a scapegoat for prior poor performance, and there is no market reaction to the announcement of CEO turnover.

Hypothesis 2c. In terms of the vicious circle theory, the probability of CEO turnover will be high when the firm performs badly, and subsequently the firm deteriorates when its successor is unfamiliar with the firm's business culture. The vicious circle continues and negative stock returns follow the turnover announcement.

The last hypothesis regards the effect of a power shift on the volatility of stock return. Adams et al. (2005) argue that a powerful CEO has more discretion to influence decisions. The final decision will reflect the CEO's opinion more directly and will be more variable than decisions made by a group of top managers. The risk arising from judgment errors is not well-diversified for firms in which their CEOs make the most major decisions. In other words, the likelihood of moderate decisions being higher in an organization in which many executives are involved in the decision-making process is greater than in an organization in which only the CEO dominates the decisions. Accordingly, this paper proposes the hypothesis as follows.

Hypothesis 3. The variability of stock prices decreases when CEO turnovers involve successors with a low level of power — that is, successors are non-powerful CEOs.

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات