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경영학 석사학위논문

**Dismissal of Newly Appointed CEOs:
A Behavioral Theory Perspective**

신임 최고경영자의 해임에 대한 연구

2013 년 2 월

서울대학교 대학원

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2013 년 2 월

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ABSTRACT

Dismissal of Newly Appointed CEOs: A Behavioral Theory Perspective

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This study examines the role of former CEO performance on dismissal of newly appointed CEOs. Drawing from behavioral theory, I propose that when the performance of newly appointed CEO is below that of the former CEO, the new CEO is more likely to be dismissed soon after his appointment. In addition, I examine firm size as a moderator in this linkage between former CEO performance and dismissal of the newly appointed CEO. Specifically, I predict that the larger the firms, the impact of board's comparison between the predecessor's performance on the successor would be reduced. The results from my analysis of CEO dismissal events among S&P 500 companies between 2001-2005 generally support my predictions.

Keywords: new CEO dismissal; CEO turnover; former CEO; CEO performance; behavioral theory; event history analysis

Student Number: 2009 – 23029

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I. INTRODUCTION

In recent years, researchers of corporate governance have increasingly been interested in over the phenomenon of the dismissal of newly appointed CEOs (Shen, 2003; Wiersema & Zhang, 2011; Zhang, 2008). CEOs are getting replaced more frequently than any other times, especially within three years upon their appointment. Studies consistently show that CEO dismissal is disruptive, often leading to lost opportunities (Khurana, 2001) and firm performance fails to improve after an involuntary CEO turnover (Wiersema, 2002). Yet, empirical evidence suggests that firms dismiss newly appointed CEOs more frequently than their counterparts with longer tenure (Shen & Cannella, 2002); these new CEOs are also subjected to higher probability of dismissal than that of three decades ago (Wiersema & Zhang, 2011). Thus, some have described CEOs as dismal as “the world’s most prominent temp workers” (Lucier, Schuyt, & Tse, 2005). Worldwide, the mean tenure of departing CEOs has decreased from 8.1 years in 2000 to 6.3 years in 2009 (Favaro, Karlsson, & Neilson, 2010).

What causes those newly appointed CEOs to be dismissed only after a brief tenure at the firm? Thus far, organizational and agency theorists have identified the negative relationship between firm performance and CEO dismissal: the poorer the firm’s performance, the greater the likelihood that the CEO will be replaced. The rationale for this prediction is two-fold. First, poorly performing firms will replace their CEOs as an organizational adaptation mechanism (Friedman & Singh, 1989; Goodstein & Boeker, 1991; Keck & Tushman, 1993; Lubatkin, Chung, Rogers, & Owers, 1989; Pfeffer &

Salancik, 1978; Wiersema & Bantel, 1993). In other words, firms in the midst of an environmental shift need to adapt to the newly changed environment and CEO replacement can be viewed as part of the adaptation mechanism (Cannella & Lubatkin, 1993; Shen & Cho, 2005). Second, following poor performance, scapegoating of the CEO occurs and she is forced to leave the firm (Denis & Denis, 1995; Denis & Serrano, 1996; Denis, Denis, & Sarin, 1997; Walsh & Seward, 1990; Weisbach, 1988). Agency theorists contend that removing a poorly performing CEO might be helpful for better alignment of interests between managers and shareholders, which can reduce agency costs (Conyon & Florou, 2002; Fama, 1980; Fama & Jensen, 1983; Furtado & Karan, 1990). Thus, CEO dismissal amidst a poor firm performance context can be understood as a sign of effective internal monitoring mechanism over the management (Huson, Parrino, & Starks, 2001; Walsh & Seward, 1990).

However, despite its intuitive appeal, empirical tests for the given relationship between firm performance and CEO dismissal have yielded somewhat limited or even inconclusive results (e.g., Fizek, Louie, & Mentzer, 1990; Fredrickson, Hambrick, & Baumrin, 1988; Morck, Shleifer, & Vishny, 1989). As such, researchers have begun to consider that not the poor performance *per se*, but the performance below expectations will cause CEO dismissal. Stemming mostly from the accounting literature, this stream of research has rendered convincing evidence showing that deviations from the *expected* performance, rather than *nominal* performance in isolation, increase the probability of involuntary CEO turnover (e.g., Bartov, Givoly, & Hayn, 2002; DeFond & Park, 1999; Farrell & Whidbee, 2003; Goyal & Park, 2002;

Puffer & Weintrop, 1991; Wiersema & Zhang, 2011). Specifically, by using expectations from analyst forecasts and other stakeholders as a proxy for performance expectation, these researchers strive to capture a more behavioral aspect of performance evaluation as the basis of executive dismissal: *the gap between the expected and actual levels of performance*.

The findings of these studies, while valuable, are not conclusive since “expected performance” set by the analysts might be susceptible to managerial impression management (Franck, Nüesch, & Pieper, 2010; cf. Schlenker, 1980). The “perceived” effectiveness of CEOs affects the likelihood of dismissal, yet the CEOs’ own ability to manipulate the impression in the eyes of stakeholders would influence such perceived effectiveness (Salancik & Meindl, 1984; Staw & Epstein, 2000; Westphal & Zajac, 1994, 1998). In short, although prior work has greatly enhanced my knowledge on CEO dismissal by specifying how performance expectations are constructed, its focus has been skewed towards using analysts’ performance forecast as a surrogate measure, which might be subject to impression management.

In this paper, I explore an alternative explanation for the dismissal of newly appointed CEOs. Specifically, I posit that the reference point that becomes the most salient in the evaluation process of a newly appointed CEO is the performance of the former CEO. In other words, if the former CEO was associated with extraordinary level of firm performance, this may actually increase the performance expectations that the successor CEO has to meet. Anecdotal evidence suggests that following a predecessor attributed to high

firm performance may increase the burden of the successor CEO, which may in turn lead to higher likelihood of dismissal only after a brief tenure. For instance, John. W. Loose, former CEO at Corning Inc., failed to meet heightened expectations of the board after filling the position of Roger G. Ackerman^①, who was chosen as one of the best-performing CEOs in the world (Hansen, Ibarra, Peyer, von Bernuth, & Escallon, 2010). Similarly, John N. Seitz, former CEO of Anadarko Petroleum Corporation, one of the world's largest independent oil and natural gas companies, was ousted only after 14 months at the helm when he succeeded Robert J. Allison, Jr., who had successfully led the firm for over 25 years. However, despite these well-known anecdotal evidences, the impact of former CEO performance on the CEO dismissal has been largely unexplored. Therefore, in this study I attempt to fill such gap in the literature. I expect that, *ceteris paribus*, a newly appointed CEO following a high-performing predecessor CEO is likely to face higher risk of dismissal than other new CEOs having no such predecessor.

Drawing from the behavioral theory of the firm (Cyert & March, 1963), I believe that while appointing and monitoring CEOs is one of the most important tasks of a corporate board, its members are still subjected to bounded rationality (Fredrickson et al., 1988; Simon, 1955).^② It is likely that

^① Roger G. Ackerman was ranked 51th in the list of the 100 best-performing CEOs in the world. For more details, visit the website (<http://hbr.org/web/extras/100ceos/51-ackerman>)

^② As noted by Shen and Cannella (2002), not only the board of directors but also other senior executives can challenge their CEO, which often leads to the dismissal of the CEO. However, such challenges from senior executives must be delivered to the board members and they should be convinced before the CEO actually gets replaced. This is because the ultimate rights to hire and fire the CEO belong to the board (Mizruchi, 1983). With this in mind, I exclusively focus on the board process of CEO dismissal for the rest of my discussion.

they will strive to minimize their cognitive effort when evaluating the performance of CEOs (March & Simon, 1958; Simon, 1947, 1955). More specifically, because the boards' evaluation of CEO performance involves a high level of complexity, they rarely attend to all of the possible factors and contingencies that would affect CEO performance. Instead, the board members are likely to minimize their information demands by adopting an anchor or a reference point easily available. This, in turn, would determine the focal CEO's perceived performance (Haleblian & Rajagopalan, 2006; Seborá & Kesner, 1996). In doing so, a reference point easily available and accessible such as the former CEO's performance may be used. After all, firm performance is one of the most extensively used criteria of CEO effectiveness (Puffer & Weintrop, 1991).

In addition, I also investigate another factor that might affect the primary relationship between the new CEO's deviated performance from that of former CEO and his or her early dismissal. If board's performance comparison between the two CEOs leads to higher likelihood of new CEO dismissal, then what factor can mitigate its impact? This question is worthy of consideration given that the board's perception of new CEO performance would be a product of bounded rationality (Haleblian & Rajagopalan, 2006; Seborá & Kesner, 1996; cf. Simon, 1955). To address the question, therefore, I highlight an organizational factor which has been much discussed in CEO succession literature: *firm size*. The size of firm has generally been found to be a major contingency variable in prior research (Guthrie & Datta, 1997). Viewing it as an indicator of established routines and organizational hierarchy,

managerial change in large firms are presumed to be a function of formalized process rather than spontaneous behavioral outcomes (Nelson & Winter, 1982; Ocasio, 1999). Thus, certain norms and cultural values within which the process of CEO succession is embedded will serve as an inertial force, preventing the CEO from being easily dismissed before proving their potential.

In addition to organizational inertia, firm size is closely associated with visibility (Hillman, Shropshire, & Cannella, 2007; Pollock, Fischer, & Wade, 2002). That is, larger firms are more visible to the public, especially in the eyes of shareholders, financial community, business press, and other stakeholders. Therefore, it is reasonable to expect that the board of directors, who oversees CEO succession, face more pressure when making the dismissal decision. I expect that, therefore, the larger the firm size, the impact of the former CEO performance on the new CEO's likelihood of dismissal will be reduced.

In short, this study explores the relationship between performance gap between the former and new CEOs and the dismissal of newly appointed CEOs. To the best of my knowledge, prior research on executive succession has not considered the link between the former CEO performance and the dismissal of the successor CEO. I also examine how this linkage can be mitigated by exploring the moderating role of firm size. In order to test my hypotheses, I constructed my sample of CEO succession events between 2001-2005 among S&P 500 companies. In the following section, I develop my theory and discuss the specific hypotheses.

II. THEORY AND HYPOTHESES

1. Performance Comparison between the Former and Newly Appointed CEOs

The presence of the former CEO often lasts longer than his or her tenure. As Vancil (1987) has documented, a CEO at times remains as the chairman of the board even after stepping down from his position. Although such cases would allow an orderly transition from one CEO to the next, the successor would find it difficult to initiate major strategic changes because of the obvious presence of the predecessor (Fahlenbrach, Minton, & Pan, 2011; Quigley & Hambrick, 2011). In cases where the former CEO discontinues his official ties with the firm and remains outside the firm, his presence may still linger within and outside the organization. Jack Welch, for instance, is still perceived as the symbolic figure of General Electric, although more than a decade has passed after his retirement. Steve Jobs, who had led Apple Inc. to one of the most successful companies in the world, has been identified with his company and is still regarded as a symbol of the company, even after his death. In a few cases, CEOs who resign – voluntarily or involuntarily – actually return to the firm. Once retired as the CEO of Starbucks, Howard Schultz returned to the CEO position in 2008 after an eight-year hiatus when Starbucks began to slip in competition. Steve Jobs at Apple is a well-known case as well. All in all, it seems that even after CEOs step down from the office, they – directly or indirectly – exert pressure on the newly hired CEO. At times, they actually remain in the pool of viable candidates for the next

turnover; at minimum, they would serve as a referent point to evaluate the new CEO's performance by.

The tendency for the present CEO to be compared to his predecessor would be more pronounced especially when the former CEO had successfully led the company during their tenure. If this referent was perceived to be a high-performer and a crucial contributor to the firm's welfare, the new CEO who is "filling the big shoes" is more likely to be perceived as incompetent. Conversely, if the former CEO as the referent was perceived to be a low-performer to which poor firm performance was attributed, the new CEO may be given a wider zone of acceptance for his performance that may or may not meet the board's expectations.

New CEOs have a formidable job as they step into the role. Many of the CEO studies have long recognized new CEO's incompetence and vulnerability (e.g., Gabarro, 1987; Hambrick & Fukutomi, 1991; Shen, 2003; Vancil, 1987). They tend to face high pressure to prove their case, especially in comparison to that of the predecessor CEO. The expectations from the board and other stakeholders within the firm surmount the executive even as they strive to acquire the functional skills and knowledge about the firm and the industry, while navigating through the intricate web of political interrelationships among shareholders, board members, other senior executives, and all other powerful stakeholders (Shen, 2003; Porter et al., 2004). As pointed out by Gabarro (1987), this process of "taking charge" takes time – as much as two or three years – and requires newly appointed CEOs to "learn the rope" before initiating major strategic actions. However, it

is in this “learning” period that new CEOs are likely to be monitored closely by the board and other stakeholders. Zhang (2008: 861) describes how these newly appointed CEOs go through the extended evaluation period even after the official appointment as the following:

“Agency theory suggests that the principal (board of directors) can learn about the agent’s (new CEO) ability over time, and that the updating of the ability estimate becomes more informative with each successive period... According to this argument, the board can update its ability estimate of the new CEO after the succession, as it observes and evaluates how the new CEO applies his existing knowledge and skills and develops new task knowledge and skills required for the successful execution of the position. As noted by Vancil (1987), new CEOs are watched closely by their boards and stakeholders because they have yet to prove themselves in the new position... In other words, a CEO succession process does not end when a new CEO is appointed. It can be a continuous evaluation process that lasts for a few years after the succession.”

To summarize, newly appointed CEOs undergo scrutiny of the boards and stakeholders and tend to be compared to their predecessor CEOs, while they are still in need of establishing their leadership and demonstrate their capabilities. This tendency is more likely to be more pronounced especially when the former CEOs are high-performers. I believe that this performance comparison process has led to the empirical findings of the extant literature showing a high probability of early departure of new CEOs after a brief stint. In the following section, I develop this theoretical premise further by drawing from behavioral theory.

2. Behavioral Theory and New CEO Dismissal

The behavioral theory deals with an organization in which a coalition of people such as managers, shareholders, and employees interact with one another (March, 1962). Built on the assumption of decision makers' bounded rationality, it provides me with a behavioral model of the evaluation process of newly appointed CEOs (March & Simon, 1958). Broadly, behavioral theory suggests that organizational decision makers strive to achieve their aspirations level, and thus, when an organizational performance falls below the aspiration level, they are likely to conduct risk-taking choices. This cognitive process using aspiration relative to actual performance has been applied to a variety of organizational contexts, including strategic change (Greve, 1998; Lant & Montgomery, 1987), R&D spending (Chen, 2008; Greve, 2003a), capital investment behavior (Greve, 2003b), mergers and acquisitions (Iyer & Miller, 2008), and even corporate misconduct (Harris & Bromiley, 2007). In this sense, behavioral theory would offer a useful theoretical lens for understanding the board's dismissal of newly appointed CEOs.

When a newly appointed CEO is dismissed, the former CEO performance is likely to have served as an aspiration level by which the board of directors evaluates the performance of the new CEO. My logic is as follows: First of all, the boards of directors often face substantial complexity when they evaluate the performance of newly appointed CEOs. Organizational scholars have shown that the effects of CEOs on firm performance are difficult to understand (Lieberson & O'Connor, 1972;

Mackey, 2008; Roquebert, Phillips, & Westfall, 1996; Thomas, 1988; Wasserman, Nohria, & Anand, 2001). Given this ambiguous linkage between managerial action and firm outcomes, it would be particular difficult for the boards of directors, subject to bounded rationality, to assess all relevant information and come to an impartial decision when evaluating the performance of newly appointed CEO. In fact, the boards have been shown to adopt strategies that simplify the decision over such complex and ambiguous situations (Sebora & Kesner, 1996; Simon, 1955). Second, because the board members are usually occupied with numerous activities outside the firm, the information processing demands is quite formidable. Most independent directors have full-time positions outside the firm in which they only serve their board duty on a part-time basis (Tian, Haleblian, & Rajagopalan, 2011). Moreover, some independent directors often hold multiple board memberships in two or more companies (Ferris, Jagannathan, & Pritchard, 2003; Fich & Shivdasani, 2006). The board of directors would not have sufficient time for an exhaustive assessment and evaluation of a new CEO's performance. Therefore, they would tend to utilize a simplified heuristics and rely on a reference point when evaluating the performance of new CEOs, simplifying their cognitive demands.

In such comparison process, the former CEO is likely to be used as a reference point. As Tversky and Kahneman (1974) noted in their seminal paper on cognitive heuristics, decision makers tend to rely heavily on one trait or piece of information, or "anchor," when making decisions. Once the anchor has been established, the decision makers tend to exhibit a bias toward

interpreting all relevant information to reflect the "anchored" information. Due to this cognitive bias, an anchor readily available to the board and other stakeholders would influence the evaluation of the newly appointed CEO. Faced with a high level of complexity of the evaluation process, then, the board of directors would strive to find easily available referent – in this case the former CEO's performance during his tenure. After all, firm performance is an extensively used criterion when evaluating CEO effectiveness (Puffer & Weintrop, 1991).

In sum, I argue that the board of directors would tend to use former CEO performance as a reference point – or an aspiration level – when they evaluate the performance of newly appointed CEOs. When the current firm performance is below than reference point established based on the former CEO's regime, the new CEO is likely to be perceived as incompetent. As the performance gap between the former and the new CEOs becomes larger, performance pressure over the new CEOs increases, and the likelihood of the dismissal of the newly appointed CEO increases. In other words, this "perceived-to-be-poor" performance will trigger the board's cognitive motivator which leads to CEO dismissal (Haleblian & Rajagopalan, 2006). Subsequently, the performance gap between the former and the new CEOs would affect the dismissal of the new CEOs.

Hypothesis 1. The greater the gap between the performance of newly appointed CEO and that of the former CEO, the higher the likelihood of the newly appointed CEO's dismissal.

3. The Moderating Role of Firm Size

Looking at such linkage between CEO performances, I believe that organizational size is likely to mitigate the impact of such performance comparison between the two CEOs. Firm size has long been found to be an important indicator of the extent to which a firm relies on an established routine in CEO succession (Guthrie & Datta, 1997; Li & Tang, 2010; Nelson & Winter, 1982). Empirical evidence has demonstrated that larger firms tend to hire a new CEO inside their firms, rather than resorting to external appointment, due to a greater pool of viable internal candidates (Dalton & Kesner, 1983; Furtado & Rozeff, 1987; Guthrie & Datta, 1997). Thus, by utilizing the internal labor market, large firms would be able to find CEO candidates without turning to outside the firm. More recently, Zhang and Rajagopalan (2004) find that firm size has positively and significantly related the likelihood of relay successions that an heir apparent takes the leadership when the incumbent CEO leaves. The underlying logic behind the argument would be that as firm size increases, for example, it is more likely that established routines are in place, which guides the process of CEO changes that is full of potential hazards and ambiguity (Ocasio, 1999). It should be noted that the presence of formal rules or processes would make the firm more inertial: the larger the firm, the greater its inertia (Hannan & Freeman, 1984). Based on the insights from prior research, therefore, I expect that in larger firms, the board's performance comparison between the former and new CEOs would be mitigated because of the institutionalized rules associated with CEO dismissal. Surely, my basic premise is that poor

performance leads to the involuntary turnover of CEOs. The relative performance gap between the predecessor and the successor CEOs, rather than just the nominal performance of the new CEO *per se*, would drive the CEO dismissal process. However, such dynamics would unfold to the extent that the pre-established and institutionalized routines and power configurations are present in the organization to serve as a buffer.

In addition to institutionalized routines and greater organizational inertia, large firms are highly visible to the public (Hillman et al., 2007; Pollock et al., 2002; Salancik, 1979; Suchman, 1995), which may affect the board's decision to dismiss the CEO. On the one hand, high visibility of the firm often leads to more pressure to conform to the expectations of stakeholders. Research has shown that larger firms are more likely to be put under close scrutiny by financial community and business press because of higher visibility (e.g., Bhushan, 1989; Wiersema & Zhang, 2011). Thus, given that CEO dismissal tends to generate a great deal of negative sentiment among stakeholders, I posit that boards may be less likely to engage in CEO dismissal even if they perceive the performance of the newly appointed CEO as poor, especially compared to that of the former CEO. On the other hand, a firm's visibility may create concerns for board of directors when considering new CEO dismissal. That is, knowing that firing a CEO can be potentially disruptive and create substantial uncertainty (Carroll, 1984; Grusky, 1961; Khurana, 2001; Ocasio, 1999), the boards of directors are likely to be reluctant to simply let go of a CEO. Their concern for reputation makes such firing decision of CEO much more difficult (Fama & Jensen,

1983). Therefore, the boards of directors may be forced to think twice before ousting the newly appointed CEO. In short, from the perspective of organization inertia and visibility, I predict that the size of the firm would negatively affect the board's process of CEO dismissal. Thus, I propose the following:

Hypothesis 2. Firm size will have a moderating effect on the linkage between relative performance of a newly appointed CEO and the likelihood of his dismissal.

III. DATA AND METHODS

1. Sample

My sample consisted of S&P 500 firms at the end of 2001. Using the Standard & Poor's ExecuComp database, I first identified all CEO successions between 2001 and 2005. Then, I verified each of these events with press releases, news articles, and the company's official filings in order to validate each of the successions in my sample. Initially, 266 CEO succession events from 217 firms were identified during my period of 2001-2005. Based on the previous literature (e.g., Ballinger & Marcel, 2010; Shen & Cannella, 2002), I then excluded CEO turnovers that involve interim CEO.^③ Due to missing data, my final sample consisted of 217 CEO successions in 187 firms, with 605 CEO-year observations in total. My primary data sources were S&P's COMPUSTAT, ExecuComp, and U.S. Securities and Exchange Commission's (SEC) Edgar database for company filings. Specifically, I obtained firm-specific information, such as size and performance, from the annual data of COMPUSTAT. Data on executive and board of directors were collected from both ExecuComp and corporate proxy statements obtained from the Edgar system.

^③ According to Baillinger and Marcel (2010), some firms use interim CEOs who temporarily lead the firm until the board names a permanent successor. In their sample, most interim CEOs hold the CEO position for less than three or four quarters. Given that interim CEOs would inevitably leave the office much sooner than non-interim CEOs, and this type of turnover operates in a completely different mechanism from the CEO succession as theorized in this paper, I decided to exclude the interim CEOs from the sample.

2. Description of the Variables

Independent Variables. *CEO performance gap* consisted of the performance gap between the two CEOs, capturing the extent to which the performance of newly appointed CEO falls below that of his predecessor CEO. While there has been much debate about whether and to what extent a CEO can have influence over the firm performance (for more details, see Mackey [2008]), I used return on assets (ROA) as a proxy for CEO performance. My rationale for using this measure was two-fold: First, firm-level performance outcomes tend to be attributed to the CEO himself. Research on CEO celebrity suggest that firm performance is primarily attributable to the individual CEO (e.g., Chen & Meindl, 1991; Cho, 2011; Hayward, Rindova, & Pollock, 2004; Meindl & Ehrlich, 1987; Meindl, Ehrlich, & Dukerich, 1985). Stakeholders would tend to rely on “simple and existing explanations of firm performance” and focus on the strategic actions that the CEOs have taken (Hayward et al, 2004: 644). Second, accounting ratios are closely tracked by the board, with ROA being probably the most widely used measures among them (Puffer & Weintrop, 1991). Most likely, then, the ROA would serve as the most predominant measure to evaluate the newly appointed CEO. Therefore, I employed ROA as a proxy for CEO performance. Given this, I calculated the performance gap between the former and the newly appointed CEOs by subtracting industry-adjusted ROA from the average industry-adjusted ROA of the former CEO during his tenure.^④ The

^④ When calculating industry-adjusted ROAs, I subtracted the average of an industry portfolio. Here, industry portfolios for each firm were constructed using all other COMPUSTAT-listed firms that shared the same two-digit SIC code.

industry-adjusted ROA that represents new CEO performance was updated yearly and lagged the dependent variable by one year. I multiplied the values by 100 for the ease of interpretation.

The moderating variable, *firm size*, was measured by taking natural logarithm of the total number of employees at $t - 1$, consistent with previous studies (e.g., Farrell & Whidbee, 2003).

Dependent Variable. The dependent variable in the study was *New CEO dismissal*, whether or not a newly appointed CEO involuntarily leaves the office within three years after the initial appointment. Of 217 CEO successions originally found, there were 51 cases in which CEOs left office within three years after taking office. Like other studies on CEO dismissal, distinguishing involuntary turnover from other types of CEO turnover (e.g., resignation) is no easy task. Following previous studies (e.g., Shen & Cannella, 2002; Zhang, 2008), therefore, I identified the reasons of all CEO turnovers in my sample, and verified them using at least two different sources of information. As a result, I excluded all CEO turnovers due to a lateral move to another comparable firm (14 cases), retirement after the age of 64 (21 cases), death or clear health issues (2 cases), or merger or acquisition (2 cases). Those cases were treated as voluntary turnovers. The remaining 12 cases were classified as dismissals of new CEOs. In order to validate each case, I relied on the news reports from media sources such as *Wall Street Journal*, *Business Week* and *Fortune*. Through this process, I confirmed that each of these 12 CEO changes was explicitly reported as an unexpected resignation due to poor performance or for undisclosed reasons. To sum up, a total of 12 CEO

succession events were identified as the dismissal of newly appointed CEOs. I coded those cases as a “1” in a year in which a new CEO was dismissed, and “0” otherwise.

Control Variables. I included several control variables that might affect the likelihood of a new CEO dismissal. First, I used a lagged measure of performance at $t - 1$ because poor firm performance would lead to forced turnover of CEO (Fredrickson et al., 1988). This variable was updated yearly and operationalized as the adjusted-ROA of the firm by the two-digit SIC codes (*Industry-adjusted ROA*). In addition, I controlled for the former CEO’s founder status and his tenure as CEO. The former CEO’s founder status was operationalized as a dummy variable: coded “1” if the predecessor CEO was a founder of the company (*Former CEO founder status*), “0” otherwise. Tenure of the former CEO was calculated as total number of years the predecessor CEO had served as the CEO of the focal firm (*Former CEO tenure*). The origin of newly appointed CEOs was also included. In line with the previous research (e.g., Cannella & Lubatkin, 1993; Zhang, 2008), I coded an outsider-new CEO as “1” if he or she had more than two years of service outside the firm, and “0” otherwise (*New CEO origin*). CEO age was the age of the newly appointed CEO at time t (*New CEO age*) (Farrell & Whidbee, 2003; Murphy & Zimmerman, 1993). Whether a newly appointed CEO jointly serves the board chair was also controlled. This dichotomous variable, new CEO duality, was coded as “1” if the newly appointed CEO also served the board chairman in a certain year; and “0” otherwise (*New CEO duality*). The level of stock ownership of newly appointed CEOs was natural log of the

percentage of shares held by the CEO in a given year (*New CEO stock ownership*). I also controlled for the proportion of outside directors on the board because it not only reflects the board's monitoring over CEO (Weisbach, 1988), but also captures the political dynamics of CEO dismissal (Ocasio, 1994; Shen & Cannella, 2002). Following Ocasio (1994), this variable was measured as the number of outside board members, excluding the number of directors selected after the appointment of new CEO, divided by the total number of directors (*Proportion of outside directors*). Lastly, following Allison (1984), I constructed two year-dummy variables because in my pooled time-series data, each CEO-year was treated as a separate observation and the dependent variable was whether or not the dismissal of newly appointed CEO occurred in a given year (*Year two; Year three*).

3. Statistical Analysis

The empirical test was conducted using a discrete-time event history analysis (Allison, 1984). In general, management researchers have employed event history analysis to analyze the influence of predictor variables on the occurrence and the timing of specific organizational events (Morita, Lee, & Mowday, 1993). Given that my dependent variable was the occurrence of the dismissal event of a newly appointed CEO over time, that is, the changing state of newly appointed CEO from being retained to being dismissed, the event history technique was a possible analytical method. Of the 605 observations, however, there were only 12 instances (less than two percent) in which the dependent variable equaled one (new CEO dismissal = "1");

otherwise = “0”). Thus, the dependent variable was highly skewed, which presented a challenge for testing my hypotheses. That is, as noted by King and Zeng (2001), popular statistical procedures (e.g., logit) may sharply underestimate the probability of rare events. To correct for this possible bias, I employed the rare-events logistic regression (King & Zeng, 2001). This statistical procedure has recently gained considerable currency in the field of management (e.g., Jensen, 2008; Kirsch, Goldfarb, & Gera, 2009; Lafuente, Bayo-Moriones, & Garc ía-Cestona, 2010; Yang, Lin, & Lin, 2010). Moreover, the population in this study fluctuated over time as some of the newly appointed CEOs were actually dismissed or voluntarily left the office within the first three years. Given that those new CEOs who either voluntarily or involuntarily stepped down from their position no longer faced dismissal, I dropped such cases from the sample. In addition, because single CEO could be observed across multiple observations, yet these observations were not independent of one another, I employed a cluster procedure, which allowed me to conduct a more conservative test (Fischer & Pollock, 2004; Zhang, 2008). All analyses were performed with STATA/SE 11.1, and the computation for rare-events logistic regression was done with the “relogit” procedure (Tomz, King, & Zeng, 2003).

IV. RESULTS

Table 1 presents the means, standard deviations, and correlations for all variables used in the analysis. While all variables in the interactions terms were mean-centered (Aiken & West, 1991; Cohen, Cohen, West, & Aiken, 2003), the descriptive statistics in Table 1 exhibits non-centered values for ease of interpretation. To check for possible multicollinearity, I computed the variance inflation factor (VIF) for all models. The results, even amongst the models in which the interaction terms were included, indicate that the largest VIF was far below 10, the accepted cutoff value (Neter, Wasserman, & Kutner, 1990), with mean VIF of 1.28: thus, multicollinearity problem was not deemed to be present in the estimation.

Table 2 provides the results of the discrete-time models testing my hypotheses. Model1 is my baseline model, including control variables and the moderators. Model 2 adds the independent variable used to test Hypotheses 1. In model 3, all the variables including an interaction term were included. As noted earlier, I mean-centered the variables involved in the interaction before calculating the interaction effects to minimize the distortion due to high correlations between the interaction term and its original variables (Aiken & West, 1991; Cohen et al., 2003).

Hypothesis 1 predicted that performance of newly appointed CEOs below that of former CEOs would increase the likelihood of new CEO dismissal. Model 2 introduces my measure of performance gap between the former and newly appointed CEOs. As shown in Model 2, performance gap between two CEOs was positively related to the dismissal of the successor

TABLE 1
Means, Standard Deviations, and Correlations for Variables^{a,b}

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12
1. New CEO dismissal	0.02	0.14												
2. CEO performance gap	-0.17	4.56	0.04											
3. Firm size	3.24	1.24	-0.03	-0.01										
4. Industry-adjusted ROA	-0.00	0.07	0.02	-0.42*	-0.04									
5. Former CEO founder status	-6.13	1.53	0.08	-0.18*	-0.13*	0.00								
6. Former CEO tenure	0.09	0.29	0.05	-0.04	0.00	0.14*	0.30*							
7. New CEO origin	0.25	0.43	0.00	0.16*	-0.05	-0.14*	0.13*	-0.17*						
8. New CEO age	53.54	6.13	0.03	0.03	0.03	-0.13*	-0.13*	-0.11*	0.01					
9. New CEO duality	0.59	0.49	-0.10*	0.05	0.18*	-0.03	-0.27*	-0.19*	0.04	0.28*				
10. New CEO stock ownership	-6.13	1.53	0.03	-0.06	-0.20*	-0.03	-0.07	-0.08*	-0.23*	0.07	0.09*			
11. Proportion of outside directors	0.78	0.11	0.00	0.03	0.03	0.02	-0.09*	-0.08*	0.00	0.04	0.10*	-0.01		
12. Year two	0.34	0.47	-0.05	0.01	-0.02	-0.01	0.00	-0.01	0.00	0.01	0.05	0.07	0.00	
13. Year three	0.31	0.46	0.06	-0.07	0.03	0.05	-0.01	0.02	-0.01	0.07	0.09*	0.14*	-0.32*	-0.48*

^a n = 605

^b “Firm size” and “new CEO stock ownership” are in natural logarithmic form.

* p < 0.05

TABLE 2
Results of Discrete-Time Analyses Predicting New CEO Dismissal^{a,b}

Variable	Model 1		Model 2		Model 3	
CEO performance gap			14.09*	(6.66)	7.08†	(4.22)
CEO performance gap x firm size					-8.85*	(4.50)
Firm size	-0.05	(0.29)	-0.07	(0.26)	-0.01	(0.25)
Industry-adjusted ROA	2.33	(2.33)	5.42*	(2.36)	5.06*	(2.36)
Former CEO founder status	0.91	(0.75)	1.45†	(0.78)	1.35†	(0.71)
Former CEO tenure	0.01	(0.04)	0.01	(0.04)	0.02	(0.03)
New CEO origin	0.36	(0.80)	0.18	(0.89)	0.37	(0.80)
New CEO age	0.08	(0.06)	0.09	(0.06)	0.10*	(0.05)
New CEO duality	-1.52*	(0.75)	-1.63*	(0.82)	-1.74*	(0.88)
New CEO stock ownership	0.18	(0.16)	0.21	(0.16)	0.12	(0.16)
Proportion of outside directors	1.27	(2.05)	2.08	(2.25)	2.46	(2.39)
Year two	-0.45	(0.83)	-0.39	(0.81)	-0.24	(0.80)
Year three	0.66	(0.67)	0.80	(0.66)	1.07	(0.72)
Constant	-7.38	(4.90)	-8.26†	(4.69)	-10.3*	(4.54)
Number of observations	605		605		605	

^a Rare-events corrected logistic regression; standard errors in parentheses.

^b “Firm size” and “new CEO stock ownership” are in natural logarithmic form.

† p < 0.1; * p < 0.05; ** p < 0.01; *** p < 0.001

CEO within three years ($p < 0.05$), consistent with my theory. Model 3 introduces a moderating variable, firm size. The result shows that the coefficient of the interaction term between the performance gap between two CEOs and firm size was negative and significant at $p < 0.05$. Thus, Hypothesis 2 was supported.

Among the control variables, surprisingly there was a positive and significant relationship between industry-adjusted firm performance and the likelihood of new CEO dismissal (Models 2 and 3, $p < 0.05$). It seems that, poor performance, at least measured in ROA, may not be the primary cause of dismissal during the initial period of a CEO's tenure. Clearly, this unexpected result will need to be investigated in the future. Former CEO's founder status was also positively and significantly related to new CEO dismissal within the first three years (Models 2 and 3, $p < 0.10$). Thus, having a predecessor who is also a founder would put additional burden on the successor CEO, leading to his early departure. In Model 3, new CEO age was positively and significantly related to new CEO dismissal ($p < 0.10$). It seems that older CEOs can be more vulnerable to the challenges from both in and outside the firm because of their commitment to old paradigm (Hambrick & Fukutomi, 1991; Hambrick & Mason, 1984). Lastly, I find a negative and significant relationship between new CEO duality and dismissal ($p < 0.05$). This result is intuitive, given the previous research findings that those CEOs serving as the chairman of the board can divert the board's attention from monitoring them (Tuggle, Sirmon, Reutzel, & Bierman, 2010). They would also have information advantage over their respective board members, especially from the outside of the firm,

effectively controlling the board meetings and take any pre-emptive actions as they see fit (Daily & Johnson, 1997; Firstenberg & Malkiel, 1994).

V. DISCUSSION AND CONCLUSIONS

In this study, I examined the role of former CEO performance as a driver of dismissal of a new CEO. Specifically, I focused on the performance gap between the former and the newly appointed CEOs and how it heightens the risk of the new CEO being dismissed only after a brief tenure. Drawing from behavioral theory of the firm (Cyert & March, 1963), I showed that the boards of directors, who are subjected to bounded rationality (March & Simon, 1958; Simon, 1955), become anchored on the former CEO's performance as a reference point when evaluating the performance of newly appointed CEO. In addition, drawing from the organization inertia and visibility perspective, I investigated how organizational size can mitigate the above relationship. My results suggest that (1) the gap between the new CEO's performance and that of his predecessor is positively related to the likelihood of dismissal of the new CEO; and (2) firm size negatively moderates the relationship between the CEO performance gap and dismissal likelihood of the new CEO.

Despite many empirical studies on the negative relationship between firm performance and CEO dismissal, to date, none has considered the role of former CEO's performance as a driver in the process. My finding that the prior CEO's performance serves as a reference point when the boards evaluate the performance of newly appointed CEOs brings additional insight onto the subject. A newly appointed CEO is seen as a politically vulnerable entity facing a variety of challenges before solidifying her political position within the firm. As previous researchers have noted (e.g., Gabarro, 1987; Hambrick & Fukutomi, 1991; Shen, 2003; Vancil, 1987), she must quickly "learn the

ropes” with a variety of daunting tasks within the first two or three years upon their appointment. The board of directors and other stakeholders, however, tend to scrutinize the new CEO under a microscope and hold them to a certain set of expectations. Such evaluation is likely to be harsh particularly when the predecessor CEO was a high-performer. All too often, board members with bounded rationality would evaluate the newly appointed CEO prematurely, ultimately leading to his dismissal soon after the initial appointment.

Another major finding of this study is that firm size moderates the relationship between CEO performance gap (between the focal CEO and the former CEO) and his early dismissal. Due to organization inertia and visibility, I argued that in larger firms, such behavioral process of CEO evaluation by the board is less likely to lead to the CEO’s dismissal. Namely, dismissal threat of newly appointed CEOs is not as dire in larger companies even when they are clearly perceived to be less competent than their predecessors. This finding on firm size is consistent with previous research (e.g., Ocasio, 1999) that suggests reliance on CEO succession rules may actually enhance the accountability and reliability of CEO succession process. Furthermore, societal expectation over a larger firm – much more visible and accountable – soars as the size of firm indeed increases. This heightened visibility and prominence would dampen the board’s urge to oust the newly appointed CEO even after his relative performance suffers.

From a managerial standpoint, the results of my study imply that when evaluating the effectiveness of a newly hired CEO, the evaluative bodies including the board of directors should make their best attempt to

minimize cognitive bias and the temptation to compare the new CEO to his predecessor. After all, CEO turnover causes a serious disruption for the organization, and frequent changes lead to a vicious circle of leadership instability (Hambrick & D'Aveni, 1992). Furthermore, although most of board members serve full-time positions outside the focal firm, they should take more responsibility for the process of CEO evaluation and succession. Supporting this view, Wiersema (2002: 74) argued that “the board, knowing that the investment community lacks patience, feels pressure to choose a replacement within three or four months. Typically, they turn the job over to an executive search firm.... Unfortunately, very few board members are able to give recruiters that kind of advice – which is the second reason most CEO firings and replacements are doomed to fail.”

My study has a number of limitations. First, I measured CEO performance using ROA, the firm's operational performance. While this measure is one of the widely used criteria in assessing CEO effectiveness (Puffer & Weintrop, 1991), it essentially captures performance only at the firm-level. Future research should explore developing a more direct and refined measure of a CEO's performance at the individual level. Second, like the vast majority of studies on CEO succession or board processes, I did not directly observe the process; I relied instead on archival data and used proxies to capture the antecedents and outcome variables. In order to delineate the exact process of evaluating CEOs, a field study would be most ideal. Future studies should strive to generate insights from more qualitative approaches. Lastly, this study was based on S&P 500 firms, most of which are large-sized

companies. Thus, generalizeability of my theory and evidence to small or private firms could not be established. Nevertheless, I hope that this study based on behavioral theory will contribute to my knowledge on CEO dismissal – particularly those newly appointed – and the role of former CEOs as referents in the highly subjective process of evaluating CEOs.

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국문초록

신임 최고경영자의 해임에 대한 연구

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본 논문은 전임 최고경영자의 성과가 후임 최고경영자의 조기 해임에 미치는 영향에 대한 연구이다. 행동적 기업이론(Behavioral Theory of the Firm)을 이론적 근거로 삼아, 본 연구에서는 후임 최고경영자의 성과가 전임 최고경영자의 성과에 미치지 못할 경우 후임 최고경영자가 그 임기 초반에 해임될 가능성이 높아질 것으로 예상하였다. 또한, 기업 규모를 조절변수로 사용함으로써, 전임과 후임 두 최고경영자 간의 성과 차이와 후임 최고경영자의 조기 해임 사이의 관계가 기업의 규모가 커짐에 따라 어떻게 달라지는지를 알아보았다. 구체적으로, 기업의 규모가 클수록 두 변수 사이의 관계가 줄어들 것으로 기대하였다. 이와 같은 가설을 토대로 2001년과 2005년 사이에 S&P 500 지수에 포함된 기업을 대상으로 실증분석한 결과, 두 가설 모두 지지됨을 확인하였다.

주요어: 신임 최고경영자 해임; 최고경영자 교체; 전임 최고경영자; 최고경영자의 성과; 행동적 기업이론; 사건사 분석

학 번: 2009 - 23029