

**The best bet: Should the new CEO acquire or divest?**

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### Abstract

This paper examines the M&A strategy of firms during the first year in office following the appointment of a new CEO and its effect on longer-term firm performance. Using a unique sample of large European listed companies, the results show that CEOs of UK firms execute more deals than their counterparts in France, Germany and Spain, which could be a reflection of both a more aggressive attitude to deal-making and differences in the legal environment in continental Europe. Furthermore, following poor financial performance in companies prior to their appointment, CEOs hired with a ‘mandate to change’, use deal-making as their strategic tool to restructure the firm, favouring divestiture. Firms with strong board power are also more likely to perform deals and favour divestitures over acquisitions in the first year of a new CEO’s tenure. Firms which mainly carry out divestitures as their deal-making strategy have a positive impact on their short- and medium-term performance during the first two years in office of a newly appointed CEO. As to the manner of the new appointment, forced and external succession is associated with performance improvement, as well as the strength of the board (using the level of institutional ownership as a proxy).

**Key words:** CEO turnover; Performance analysis; Institutional investors; Mergers and Acquisitions; Divestitures.

**JEL classification:** G34.

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### **1 Introduction**

*“The world's chief executives have rediscovered their animal spirits. It is not just Irene Rosenfeld, combative boss at Kraft Foods, who has reached for the corporate chequebook in recent weeks in her pursuit of Cadbury. Bob Iger at Disney signed off on the \$4bn (£2.4bn) purchase of Marvel Entertainment, home to the Incredible Hulk, Spiderman and a host of other cartoon heroes, just seven days earlier...*

*“...To understand the sudden turnabout, one has to look to the psychology of the C-suite, the chief executive's office. The average tenure of a corporate boss is short – shorter, certainly, than a single economic cycle. That concentrates minds. M&A offers them an opportunity to reshape their companies at a stroke, an off-the-shelf legacy.”*

The Independent, 9 September 2009

The event of replacing a CEO has a major impact on the strategy of corporations. CEO turnover means change in leadership and often changes to the previous style of leadership. Top management turnover also signals changes in future corporate decisions, which could involve attempt to reverse previous management's mistakes or the establishment of new policies including investment or divestment of assets (Weisbach, 1995). This paper adds to existing literature by examining the relationship between CEO succession and subsequent deal activity, and posit that as a change in CEO signals a will/need for a change in strategy and as deals are often used to shape or re-shape strategy there should be a clear link between the two events.

Because of the seemingly importance of CEO succession, this is an area which has received a great deal of attention from scholars in the past. CEO succession is often described in the context of forced versus voluntary turnover (Parrino, 1997), or internal and external versus routine change (Kaplan and Minton, 2006). Forced or internal turnover is associated with disciplinary actions taken by the board of directors which should act on behalf of the company shareholders. If the performance of the CEO has been disappointing or otherwise if the CEO is in disagreement with the board on issues concerning the management of the firm, the

disciplinary actions taken by the board will result in the dismissal or resignation of the CEO. External disciplinary action happens as the company becomes the target in a takeover process; or is part of a merger where the partnering company's CEO becomes the CEO for the combined firm; or when the shareholders of the company sell out shares to another firm in a hostile takeover; or when other stakeholders force a change in management through a bankruptcy procedure. All of these events could be viewed as disciplinary or punishing the current management since going forward the executive decision will be taken elsewhere. Routine turnover includes all 'normal' succession of CEOs due for example to retirement. This type of succession is significantly different from the other succession types as it does not send out the same signal of change and does not derive as the result of pressure from the board or from other stakeholders (Huson et al., 2004). If a company is experiencing a 'normal' succession where the CEO is not forced out by the board, the outgoing CEO will almost always be part of the selection process of the replacement CEO (Vancil, 1987), and hence the new CEO is more likely to follow in the footsteps of the outgoing CEO. Routine takeover can be further extended to include death, illness, or poaching of the CEO by another firm. Following Dedman (2000) these types of succession should not be classified as disciplinary. In the spirit of Kaplan and Minton (2006) this report makes use of their turnover classification, internal (forced), external and routine, when analyzing reasons for CEO succession.

As seen above, the literature on CEO succession is extensive but surprisingly the link between CEO succession and subsequent deal activity, both seemingly important corporate events, has yet to be examined. This paper aims to fill this existing gap in the literature by measuring the immediate strategy of newly-appointed CEOs, with a focus on deal activity during the CEOs first year in office, and its effect on longer-term firm performance. This period is considered key for the CEO as he or she will be followed closely both from within (staff and the board) and by outside stakeholders, particularly shareholders, clients, analysts, and competitors.

Actions taken during that first year and the outcomes of those actions will very much decide the course and even success of the CEO's tenure (Dedman, 2000) and this so-called 'honeymoon period' is usually the easiest time for the CEO to make changes within the firm. In addition, this paper adds to the literature by testing existing theories relating to the reasons for CEO succession and post-performance depending on the type of succession on a unique sample of large European companies. To ensure that the sample includes deals of significant size, only the top quartile of all deals sourced for the selected companies, measured by deal value over market value of acquirer/seller, are included in the analysis.

Compared to the CAC 40 and DAX 30, this paper finds that firms listed on the FTSE 100 and IBEX 35 exhibit a higher percentage of both non-routine successions and outside recruitment, indicators of higher surveillance and disciplinary action in the UK and Spain compared to France and Germany. CEOs of UK firms execute more deals than in the other three European countries which could reflect both a more aggressive attitude to deal-making and also differences in legal environment in Europe. Following Rossi and Volpin (2003), strong shareholder protection increases M&A activity, so companies operating under a common law system such as the UK enjoy higher investor protection rights compared to the other three which operate under a civil law system.

The findings of this paper also show evidence that CEOs which have been hired with a 'mandate to change' i.e., the succession is forced by the board and the successor is recruited outside the firm (typically correlated events), use deal-making as a strategic tool to change the course of the firm as they exhibit higher deal activity during their first year in office, normally as a result of poor performance in the year prior to their appointment.

The results also reveal that newly appointed CEOs for firms with strong board power (utilizing the percentage of institutional ownership as a proxy for the strength of the board) display more

intense deal activity during their first year in office and are more likely to perform divestitures, as opposed to acquisitions. Divestitures are also more common in cases of poor firm performance or underperformance of the departing CEO compared to board expectations.

In what concerns the performance of the newly-appointed CEO, firm performance in his/her first two years in office is positively associated with deal making, in particular with divestitures, though the optimal number of deals still remains unclear. Newly-appointed CEOs who replace departing CEOs as a result of forced succession bring performance improvements, and the same result of improvement is shown when an external successor is recruited, supporting Huson et al. (2004). In addition, this paper confirms the findings of Weisbach (1988), Perry (1998), Huson et al. (2001) with evidence of improved performance post-succession if the board is strong.

This paper is relevant to academics and practitioners alike as not only does it provide evidence that CEOs use deals to change the strategic course of the firm while giving proof to what strategy is optimal in terms of long-term performance, but also the findings relating to the influence of institutional investors on deal-making will hopefully stimulate a discussion around the topic of the role of the board shifting from solely monitoring to more executive and decision-making. The remainder of the paper is organized as follows. Section 2 provides a review of the literature and formulates the hypotheses. Section 3 describes the sample selection process as well as the methodology used in the study. Section 4 discusses the empirical results and Section 5 concludes.

## **2 Literature review and hypotheses setting**

Furtado and Karan (1990) argue that proper succession plans are vital in determining a firm's profitability in subsequent periods and further prove that post-succession performance is dependent on the type of turnover used. CEO succession can be classified as internal (forced)

and external versus routine change (Kaplan and Minton, 2006) or forced versus voluntary (Parrino, 1997). Voluntary turnovers are usually planned, and hence do not have a negative impact on a firm's share price. An example of a planned turnover is in the event of a customary retirement, where the incumbent CEO announces plans to step down at a specified date in the future. Studies by Evans, Nagarajan and Schloetzer (2010) have shown that the existing CEO is highly likely to be retained on the board for an unspecified amount of time if the firm's historical performance is adequately strong to ensure a smooth transition of authority. Friedman and Singh (1989) add that customary or planned retirements are usually smooth transitions as the incoming successor is an executive is one that the board of directors and management is already familiar and comfortable with.

The obvious focus of most studies is the CEO succession as a result of an internal or disciplinarian action (non-routine) since it includes the involvement of the board, with linkages to corporate governance control, monitoring, and action. Also, the need for a forced change in CEO has a signaling effect which could be perceived either as positive or negative by the market. If investors believe that the change will improve management and subsequent cash flows the market will react positively. It could also be argued that the forced change in management is a signal of previous management wrong-doings, which could be unknown to investors at that point at which they would react negatively (Huson et al., 2004). However, studies by Salas (2010) find that there is a positive reaction in share price if the tenure of the outgoing CEO exceeds 10 years, as this may be an indicator of managerial entrenchment and the presence of moral hazard, where shareholders' interests were not maximized.

Several authors have studied non-routine CEO turnover following poor performance (Coughlan and Schmidt, 1985, Warner et al., 1988, Weisbach, 1988, Gibbons and Murphy,

1990, Murphy and Zimmerman, 1993, Blackwell et al., 1994, Kang and Shivdasani, 1995, Dedman, 2000, Huson et al., 2004); bankruptcy (Hotchkiss, 1995, and Gilson, 1989&1990); or poor acquisitions (Lehn and Zhao, 2006). Lehn and Zhao (2006) show that 57% of CEOs were replaced following an acquisition, of which 83% were replaced within five years. Others have found that poor performance of the industry and market as a whole increases the level of CEO turnover (Kaplan and Minton, 2006). This issue is also discussed in the context of boards failing to filter exogenous shocks by giving unworthy credit or blame to CEOs for performances caused by external and uncontrollable factors (Jenter and Kaanan, 2006). The role of corporate governance as a determinant of CEO succession includes discussions around the control, monitoring and executing power with which the board can discipline poor performing managers and includes factors such as board size, board independence, leadership structure, ownership structure, and CEO ownership (Bearle and Means, 1932, Fama and Jensen, 1983, Demetz and Lehn, 1985, Weisbach, 1988, Hermalin and Weisbach, 1988, Morck et al., 1988, Gilson, 1989, Jensen, 1993, Yermack, 1996, Brickley, Coles and Jarrell, 1997, Denis et al., 1997, Dahya et al., 1998, Dedman, 2002, Goyal and Park, 2002, Lehn, Patro and Zhao, 2004, Lehn and Zhao, 2006). The results supporting the theories are somewhat diffuse however, with for example Lehn and Zhao (2006) presenting weak or non-existing evidence of a relationship between disciplinary actions and the strength of the board. Dedman (2000) provides evidence of a reduction in managerial entrenchment as the institutional ownership levels rise (ownership structure) and as the role of CEO and chairman (leadership structure) is divided. Her study supports the negative impact of CEO ownership on the likelihood of forced departure but fails to provide evidence of the number of non-executives board members (board independence) implying more board control which gives a higher probability of forced departure. There are some studies concerning the strength of the board and the firm performance following CEO turnover which suggest that effective corporate governance should positively affect the



subsequent performance (Weisbach, 1988, Perry, 1998, Huson et al., 2001). Huson et al. (2004) provides evidence which support this theory to some extent. Their paper shows that the improvement of firm performance is positively related to level institutional shareholding and board independence. In addition, the paper finds no supporting evidence that the change in performance post-succession is significantly different for forced and voluntary turnover. The strength of the board has been proved to affect managers investment decisions in that weaker board vigilance accentuates the exercise of hubris through higher premium payments in acquisitions (Hayward and Hambrick, 1997). It has also been found that the market reaction to acquisition announcements is more positive when the CEO and chairman are separate positions (Masulis et al., 2007). This evidence supports the conclusion that better corporate governance control will enforce better investment choices made by the CEO.

Another theme which is explored thoroughly in the literature concerns whom to choose as the successor of the outgoing CEO, and particularly, the decision of choosing an insider versus an outsider. An insider is cheaper to recruit and will be familiar with the business and its culture but might not be as effective to advocate change. An outside CEO is costly to find and recruit and this strategy will only be chosen if incremental change is needed (Dalston and Kesner, 1985). Theories state that a successor from the outside is an essential ingredient for a turnaround strategy (Starbuck and Hedberg, 1977) which is proved by evidence that performance post-CEO turnover is positively related with an outside succession (Huson, et al. 2004). Additionally, analyses of US CEOs from 1986 to 2005 by Ang and Nagel (2009) have shown that internal successors produce stronger financial performance on average, outperforming external CEO successors by 0.57 percentage points. Ang and Nagel (2009) further state that these superior results can be attributed to the fact that internal CEO successors have first-hand industry and firm-specific knowledge and experience. This is advantageous for

the internal CEO successor in initial few years, whilst the externally-hired CEO has to spend the first few years building up the required skill set necessary for the job (Ang & Nagel, 2009).

A change in management, and particularly when the CEO turnover is forced, is believed to signal that the board, representing the shareholders, wants a change in leadership style and corporate strategy. Personnel practices, marketing strategies, and general strategic approach are all policies where one could expect to find changes when a new CEO takes office (Weisbach, 1995). It has also been argued that CEO successors will have a great influence on subsequent production and investment decisions (Beatty and Zajac, 1987).

This section discusses the drivers of CEO succession and the decision behavior of the newly-appointed CEO in terms of asset transfers through investments or divestitures. The section concludes with the examination of existing theories and empirical evidence concerning how (un)successful managers are by (destroying) creating value when deciding to invest or divest assets.

### ***2.1 Asset transfer as means to change the strategy of the firm***

The act of CEO succession is often an indication of change in corporate strategy. Personnel practices, marketing strategies, and general strategic approach are all policies where changes are expected when a new CEO takes office (Weisbach, 1995). It has also been argued that CEO successors have great influence on subsequent production and investment decisions (Beatty and Zajac, 1987).

The internal non-routine succession, forced through by the board, is concluded to be of most interest when studying enforced change in an organization. Equally, the appointment of an

external CEO is believed to signal the need for change (Dalston and Kesner, 1985) that can therefore be linked to the need for subsequent change in corporate strategy, which could be achieved through asset transfers. If the board, acting on behalf of the shareholders, is looking to force the current CEO to resign, they are in effect looking for a change in leadership and subsequent change in strategy. The literature has provided evidence that new CEOs tend to adopt strategies in asset transfers which reverse the strategies of previous CEOs. As shown by Porter (1987), Ravenscraft and Scherer (1987), and Kaplan and Weisbach (1992), divestitures of recently acquired assets are very frequent and it could therefore be assumed that CEOs which are appointed to enforce change in an organization will be more inclined to adopt a reversal strategy, typically in the cases of appointment of outsider, poor performance pre-succession, and strong board. This discussion leads to the following hypothesis:

*H1a: The newly appointed CEO will be more likely to engage in asset transfers during his/her first year in office if he/she was appointed following an internal succession forced through by the board.*

*H1b: The newly appointed CEO will be more likely to engage in asset transfers during his/her first year in office if he/she was recruited externally.*

Zhang and Rajagopalan (2010) have found that externally hired CEOs have a greater detrimental impact on firm performance as compared to internally hired CEOs, especially in times when strategic change is crucial. Additional barriers that may hinder an external CEO's corporate divestiture strategy include unstable conditions (Karaevli and Zajac, 2013) and a lack of knowledge and experience within the firm (Shen and Cennella, 2002; Wiersema, 2002).

Chiu et al (2016) find that newly promoted internal CEOs have greater firm-specific knowledge and are in a better position in determining the business units which should be divested whereas externally hired CEOs may find it challenging given their lack of a concise understanding of

the firm, especially when it involves multiple product markets and business units (Naveen, 2006). There are several factors which have been identified as drivers of internal succession or external recruitment. Poor performance, poor industry performance and poor overall market performance, have all proved to be preceding internal succession forced through by the board. Even if the change in management is not a forced succession, provided any of these factors exist ex-ante the assumption will be that the board expects incremental changes i.e., the new CEO will be more inclined to change strategy ex-post. This leads to the following hypotheses:

*H1c: The newly appointed CEO will be more likely to engage in asset transfers during his/her first year in office if the firm was performing poorly prior to the succession.*

The strength of the board impacts the level of disciplinary action taken against the poor performing manager and subsequently impacts the performance of the firm under new management (Huson et al., 2004). It can therefore be concluded that the level of change desired by the board and subsequently enforced will be related to the strength of the board, proxied by the percentage ownership of institutional investors, following findings of Dedman (2000). This argument leads to the following hypothesis:

*H1d: The newly appointed CEO will be more likely to engage in asset transfers during his/her first year in office if the board is strong.*

## **2.2 The optimal strategy**

It has been documented that even though corporate takeovers can create value for the combined entity it seems to be at the expense of the acquirer shareholders' wealth (Jensen and Ruback, 1983). One of the most commonly explored theories to explain why managers pursue acquisition strategies is that of managerial hubris. According to this theory, managers pursue takeovers because they are infected by hubris which makes them overestimate their own ability

to manage the target firm and hence overpay (Roll, 1986). This issue results in large premiums, negative market reaction on the day of the announcement, and subsequent poor performance of the acquiring firm (Hayward and Hambrick, 1997).

As takeovers are initiated by CEOs, they typically reflect individual decisions (Roll, 1986). It has been shown that the decisions made by CEOs are often an act of hubris and self-interest. The strength of the board will determine how well this agency problem can be managed. The disciplinary act of forcing a change in management is proof of the strength of the board and a testimony of the board's ability to control the acts of the CEO. The appointment of an external successor points to the same evidence. This reasoning leads to the following hypotheses:

*H2a: The strategy in asset transfer adopted by the newly appointed CEO in his/her first year in office will be more likely to be successful if he/she was appointed following an internal succession forced through by the board.*

*H2b: The strategy in asset transfer adopted by the newly appointed CEO in his/her first year in office will be more likely to be successful if he/she was recruited externally.*

*H2c: The strategy in asset transfer adopted by the newly appointed CEO in his/her first year in office will be more likely to be successful if the board is strong.*

Managers' decision of making an investment is largely ruled by the firm's ability to make that investment. The free cash flow theory argues that managers of firms with excessive cash flows will be more wasteful as the disciplinary control mechanism of debt is weaker (Jensen, 1986). However, evidence from the UK shows that acquirers with higher free cash flow perform better than acquirers with low free cash flow (Gregory, 2005). These conflicting theories give indication that the cash flow will have an impact on the success albeit it cannot be given a prior in either direction, hence:

*H2d: The level of cash flow is expected to have an impact on success of the strategy adopted by the new CEO in his/her first year in office.*

There is evidence pointing at the frequency of acquisitions having an effect on deal success in terms of value creation. However, the theories and evidence are often contradicting. One line of thought describes that the learning acquired by making a deal will improve the outcome of the subsequent deal. Jaffe et al. (2009) find that differences in skill difference compared to previous deals is attributable to the CEOs themselves, not the firms. Some authors find evidence that performing a subsequent acquisition too close to the first acquisition can have negative impact on deal success (Fuller et al., 2002), while others state that waiting too long between performing deals can diminish the learning curve (Hayward, 2002). This conflict in the existing literature on whether higher deal activity improves or hampers success leads to the following hypothesis:

*H2e: The number of deals in the first year will have an impact on the success of the strategy.*

#### *Other CEO Characteristics*

There are various CEO characteristics which can be accounted relating to the issue of succession . Companies have traditionally hired ex-CEOs to fill CEO positions, as this ensures that the successor has necessary experience and expertise as the head of a business (Hamori & Koyuncu, 2015). They argue experienced CEOs often produced negative post-succession performance. Elsaid et al (2011) supports this argument, as CEOs with prior experience may be tasked with more complex assignments, resulting in increased difficulty levels in meeting the firm's strategic objectives. This indicates that besides the origin of the successor (internal or external appointments), prior CEO experience also has an impact on the stock market's reaction as well as post-succession performance measures.

Scharfstein and Stein (1990); Hirshleifer and Thakor (1992); Zweibel (1995) and Holmstrom (1999) found that younger CEOs with career concerns tend to adopt a more risk-averse approach due to the lack of reputation as compared to more well-established managers. Hence, such younger CEOs can be penalized through reduced future career opportunities, inducing them to utilize more conservative strategies.

However, based on Prendergast and Stole's (1996) research model, it is predicted that younger CEOs take a significantly more aggressive and risk-loving approach towards investments due to a tendency to exaggerate and over-inflate their actual ability to appear competent. One such example is Yahoo Japan, who hired a 44-year-old CEO alongside seven other relatively young senior executives, citing a need for a senior management team that had no qualms about taking risks to maintain competitive advantage (Osawa, 2012).

To further examine the impact of CEO's age on firm risk, Serfling (2014) documents a negative relation between CEO age and investment in operating leverage and research and development (R&D), which is consistent with the prediction that younger (older) CEOs undertake more (less) risk in investment decisions. Furthermore, older CEOs have a higher tendency to partake in diversifying across business segments and make diversifying acquisitions in the case of mergers and acquisitions (M&A). This reluctance in embracing riskier strategies may be caused by pay-offs that are expected to materialize after the CEO has retired (McClelland, Barker & Oh, 2012), hence, the CEO has no personal upside and motivation in undertaking such a risk.

### **3 Sample and Methodology**

#### ***3.1 Sample***

### **3.1.1 CEO Sample**

The aim of this paper is to give a European perspective of issues concerning CEO succession and subsequent asset transfer strategy. The four largest economies in Europe were chosen as geographical sample, France, Germany, Spain, and UK. For each country the constituents of each main stock index at the December 2015<sup>1</sup> were included as the initial sample, the French CAC 40, the German DAX 30, the FTSE 100, and the Spanish IBEX 35.<sup>2</sup> The main indices have been chosen as sample since they include the largest firms, in the spirit of Huson et al. (2004) and Kaplan and Minton (2006), and as the listed firms will be subject to the rules and regulations of that country. As the purpose of the study involves analysis of deal activity it was considered appropriate to exclude all investment firms, for which the act of investment and divestiture of assets is more operational than strategic.

The CEO turnover sample was collected manually. Following Huson et al. (2004) this study focuses solely on CEO succession as it is considered to have more impact than other managerial turnover. Even though the sample size may be smaller when excluding other managerial turnover, the economic significance will be stronger as the succession results in a clear change in leadership. Only CEOs which were appointed after the 31<sup>st</sup> of December 1996 were considered and the cut-off date for the data collection was the December 2015, which resulted in a total sample period of 20 years.

Information on CEO's tenure starting and ending dates as well as reasons for leaving/appointment was obtained from the Factiva and Bloomberg databases primarily using press and company releases. This information was complemented with company's profiles, management career history, press releases, as well as company's annual reports.

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<sup>2</sup> Arcelor Mittal is listed on both the French CAC and the Spanish IBEX and to avoid double-counting, the company was excluded from the IBEX index.



A previous CEO's **reasons for leaving** include the following options:

- **Forced** – Cases when the CEO was fired, the contract was not renewed, or the company's previously poor performance led to the CEO's departure;
- **Merger** - Cases when a new CEO was appointed due to a preceding merger;
- **Bankruptcy** - Cases when a new CEO was hired at the time when a company emerged after a previous bankruptcy;
- **Anticipated** - Cases when a CEO retired/old age as well as cases when he/she stayed with the company as a director/other senior position;
- **Not Anticipated** - Cases of death/medical/private reasons and situations when a CEO was poached by another company.

**Reasons for appointment/succession** depend on the reasons for leaving explained above and include the following (see Kaplan and Minton, 2006):

- **Internal** - Previous Forced;
- **External** - Previous Merger and Previous Bankruptcy;
- **Routine** - Previous Anticipated and Previous Not Anticipated;
- **Other** (excluded from sample) - **IPO** includes cases when a new CEO was appointed following a company's IPO and **N/N** are successions for which no reason could be determined.

**Insider vs. outsider recruitment:** A CEO was considered internal if he/she was promoted from within the company and in cases when a CEO was a family member of one of the founders/directors where it was clear that he/she had a good understanding of the company's operations. Otherwise the succession was classified as outsider.

As the paper investigates the immediate asset transfer strategy of the newly appointed CEO, all CEOs with a total tenure of less than one year have been excluded from the sample. The final sample includes 276 CEO successions from 171 companies.

### **3.1.2 Deal Sample**

For each firm included in the database, a search was performed for acquisitions and divestitures conducted during the sample period, sourced from the Thomson ONE Banker database. Only deals where at least 50% of shares were purchased in the transaction were included in the sample. In the spirit of Faccio et al. (2006) and Rossi and Volpin (2004), privatizations, recapitalizations, self-tenders, exchange offers and repurchases were excluded. Furthermore, to ensure that the sample included only significant deals, for each deal a ratio of deal value to acquirer or seller market value two days before announcement (Jaffe et al., 2009) was calculated, and only those with a deal value to market value in the top quartile of the original sample were included. This approach gave a final deal sample of 577 cases with a median deal value to market value of acquirer/seller of 7.82%.

## **3.2 Data**

Data items for share prices and the correspondent market indices were sourced from Thomson DataStream. The information on ownership held by institutional investors, here used as a proxy for the corporate governance mechanisms or the monitoring and disciplinary power of the board (following Lehn and Zhao, 2006) was sourced from Thomson ONE Banker for each firm and year.

Note that all data items were adjusted to the CEO's tenure i.e., if the tenure of the CEO was two years, only data for up to two years after succession of that CEO was included in the sample.

### **3.3 Methodology**

#### **3.3.1 Variables and statistical tests**

To gain a high-level understanding of the characteristics of the different variables, a univariate analysis of the mean value of deal activity in the first year depending on type of succession and type of recruitment was performed. In order to analyze share price performance, a long-term event study was performed. The cumulative abnormal returns (CAR), that is the daily cumulative returns for each firm less the daily returns for the corresponding stock market index, were calculated. Furthermore, a correlation analysis was performed between all variables and the deal activity in the first year as well as the acquisition activity relative to the divestiture activity in the first year. Finally, a multivariate regression analysis was performed to test the findings from the univariate and the correlation analysis together with additional tests relating to post-succession performance, measured by ROA (Return on Assets) and CAR.

Note that for all tests, the deal activity refers exclusively to the first year in office as the view taken by the authors in this paper, and following Dedman (2000), is that this ‘honey-moon’ period is when new the CEOs will have most power to impact the firm and course of its strategy. It is also the period during which the new CEO will be intensely monitored both internally and externally, hence it is of great importance for the CEO to leave his/her mark and opportunity to prolong the tenure. Table 1 presents the list of variables used in this study and a summary description.

#### **3.3.2 Peak-to-Trough**

The methodology used to classify the various time periods in the sample is a ‘peak-to-trough method’ following Carapeto et al (2009). The idea is to cluster periods within the full time period during which the market behaves in a similar manner. The MSCI World index as a proxy for economic cycles as it is the most widely recognised world index.

The first step is to identify major troughs by studying an exhibit of the MSCI World index development over our time period. A major trough is defined as a steep decline in index levels followed by an increase. Once the troughs have been identified, we can then identify the major peaks before and after the trough, and also find the mean value in between the peaks and troughs. The time period between the previous peak and the mean value in between is numbered 1 and corresponds to when markets have just started to fall after a major peak. The period between the mean value and the trough is numbered 2 and corresponds to the period when markets are falling towards a trough. The next period is from the trough to the mean value in between the trough and the next peak. This is numbered 3 and corresponds to when markets are starting to rise after a trough. Finally, the period from the mean value to the next peak is numbered 4 and corresponds to the period when markets are rising towards a peak. All other periods (e.g. at the beginning and end of the sample period) are given the value of 0 and excluded from the study.

### ***3.4 Sample analysis***

Table 2 illustrates the sample characteristics. It is interesting to note that the sub-samples of firms listed in the UK (FTSE 100) and in Spain (IBEX 35) have a higher percentage of both non-routine successions and outside recruitment, indicating that the surveillance and disciplinary action is higher in these two countries compared to France and Germany.

Table 3 shows that in general, Germany seems to have a more stable succession of CEOs and the boards are perhaps more prudent as the sub-sample of firms listed on the DAX 30 have both a higher median CEO tenure but that the CEOs hired in succession have the highest median age at appointment. CEOs of UK firms have the highest median value of deal activity throughout the tenure which could be a reflection of both a more aggressive attitude to deal-making but could also be a sign of the differences in legal environment in Europe. It has been

shown previously that strong shareholder protection increases M&A activity (Rossi and Volpin, 2003). Companies listed in the UK operate under a common law system which is considered to have higher investor protection rights compared to the other three countries in this sample, France, Germany and Spain, all of which use civil law legal systems (La Porta, 1997).

## **4 Findings**

### ***4.1 CEO succession and subsequent asset transfer strategy***

Table 4 shows results of the univariate analysis. The univariate tests of the mean deal activity for the different sub-samples highlights that the sub-samples including CEOs which have been hired with a ‘mandate to change’ i.e., the succession is forced by the board or the successor is recruited outside the firm, have higher deal activity during their first year in office, thus supporting H1a and H1b.

As discussed by Huson (2004) and Dedman (2000), poor share price performance is typically related to non-routine succession. If CEOs which are hired with a mandate to change use deal-making as a tool to change the course of the firm it should be expected that the deal activity in the first year following succession is indeed related to poor performance. The results of the first correlation analysis, correlating deal activity with independent variables (Table 5), confirm this theory, as CAR Y-1 (cumulative abnormal returns measured one year prior to CEO succession) is negatively correlated to deal activity, supporting H1c. Furthermore, the analysis shows a positive correlation between forced succession and deal activity (supporting the univariate test), and interestingly also highlights a positive correlation between deal activity and percentage ownership by institutional investors, supporting H1d.

As pointed out by Hayward and Hambrick (1997), weaker boards should increase the risk for hubris behavior which leads to poorer acquisitions. Further correlation analysis presented in Table 6 shows a negative correlation between percentage of ownership held by institutional investors and the percentage of acquisition activity out of total during the first year following succession, which could indicate that stronger boards will also push the new CEO to perform divestitures rather than acquisitions. To some extent this proves that CEOs will use divestitures of assets rather than acquisitions if the firm is performing badly and/or the previous management had underperformed to expectations of the board, as proven by forced succession being negatively related to acquisition activity in the first year, whilst CAR Y-1 is positively related to acquisition activity.

In addition to the findings relating to the dependent variables (deal activity and acquisition activity in the first year following a CEO succession), the correlation analysis in Table 5 and 6 shows that a negative correlation exists between forced succession and share price performance (CAR Y-1), profitability (ROA Y-1), and index performance Y-1 which is consistent with the findings of Huson (2004) and Kaplan and Minton (2006). As expected, forced succession is positively correlated with outside recruitment, which reinforces the theory of changing the firm through the forceful removal by board of the CEO and finding a replacement outside the firm, who will bring 'new blood' to the struggling company. Interestingly, the regression analysis highlights that an outside recruitment is more likely if the percentage of institutional investor ownership is high.

The multivariate analysis (Table 7) confirms that CEOs which were appointed following a forced succession will be more deal active during their first year in office, and that the strength of the board (percentage of institutional ownership) positively affect the deal activity in the first year. Furthermore, cash flow (here measured as EBITDA/Sales) levels in the year prior to the deal is shown to be positively related to overall deal activity with further analysis shows

that the relationship is driven by the relationship with acquisition activity (Table 8). These results are consistent Alex (2009) who suggests that frequent acquirers have higher levels of cash flow. In addition, company performance (measured using cumulative abnormal returns one year pre-succession) is confirmed to be negatively related to deal activity. The findings from the multivariate analysis confirm hypothesis H1a and H1c and supports findings from the correlation analysis indicating that company performance and ownership structure are associated with acquisition versus divestiture activity in the first year in office.

For the multivariate regression analysis the following control variables were also included:

*Company performance in the year prior to succession:*

In addition to using the cumulative abnormal return (CAR) as a proxy for company performance pre-succession, accounting measures of company profitability (industry adjusted ROE and ROA) for the year prior to succession, were included in the regression analysis as control variables. As suggested by Huson (2004) and Kaplan and Minton (2006) the type of succession will depend on the company's performance, as firms which are performing poorly will be in greater need of significant change. This can be extended to deal activity in the first year, as CEOs who are appointed when the company is performing poorly will be more inclined to make a significant impact and change the course of the firm. The results of the regression analysis confirms the relationship deal activity and the share price performance pre-succession and also the relationship with profitability in using industry adjusted return on assets (ROA). However, the regression fails to provide evidence of a relationship with industry adjusted return on equity (ROE). Furthermore, Hughes (1989) suggests that acquisition propensity grows with ROA but the regression analysis fail to provide evidence supporting this theory.

*Company leverage in the year prior to the succession:*

As discussed by Morellec and Zhdanov (2008), the leverage levels of the acquirer will negatively affect the acquirers' ability to win a bid of a target, i.e. the lower the leverage levels of the acquirer the higher deal activity (and particularly acquisition activity) during the first year post-succession can be expected. In this paper both total debt to total assets (Leverage measure 1) and total liabilities to total assets (Leverage measure 2) are used as proxies for the acquirers leverage levels. The regression analysis of this report fails to support any relationship between acquirer leverage levels and deal activity.

*CEO age at the time of succession:*

The issue of the age of the new CEO which is appointed at succession has been discussed by several scholars in the past. Wang and Davidson III (2009) state that firms with high managerial discretion will appoint younger CEOs and vice versa. As higher managerial discretion will give the CEO more leeway to perform deals, the CEOs age at time of succession have been included as a control variable for deal activity during the first year in office with the expectation of a negative relationship between the age of the appointed CEO and deal activity. However, the regression analysis provides no evidence supporting this theory.

*Company size at succession:*

Hughes (1989) suggests that acquisition propensity grows with company size. This paper makes use of market value (log) at succession as a proxy for size but finds no supporting evidence supporting of a relationship between company size and overall deal activity during the first year post CEO succession and neither does it confirm the relationship with acquisition activity as a proportion of total in the first year post-succession.

## **4.2 Do CEO's make wise decisions?**



The multivariate analysis (Table 10) of CAR +2 shows that the success of the strategy is related to the number of divestitures performed in the first year. Divestitures are often a good way to boost cash flow and to focus on core and these types of deals are often welcomed by the market.

In addition to the findings related to deal structure, the analysis of CAR shows that replacement CEOs who are hired in a forced succession are successful with their turnaround strategies and improve performance, at least in the medium-term (CAR Y+2), supporting H2a. Not surprisingly, newly-appointed CEOs who replace departing CEOs in an external succession underperform the market in the second year following succession. As this type of succession is usually a merger, the first two years will often be challenging as the two firms need to integrate. Finally, there is clear evidence that recruiting an ‘outsider’ is a successful strategy for changing the course of the firm as this subsample show an improvement in performance both in terms of CAR Y+2 and ROA Y-1 to Y+3 (Table 9 and 10), supporting hypothesis H2b.

Interestingly, the multivariate analysis (Table 9 and 10) of performance highlights the impact of strong boards, here measured as the percentage of ownership held by institutional investors, on company performance. In the long-term (ROA Y-1 to Y+3) the percentage of institutional investors is positively related with company performance. As shown in the previous section, the institutional ownership influence the choice of CEO succession, recruitment and immediate deal strategy and this section provides evidence that the institutional ownership also influence company performance, thus supporting H2c consistent with the findings of Huson (2004).

This paper also provides evidence (Table 10) supporting Jensen (1986) that firms with much additional cash tend to waste resources which decrease profitability in the long-term (ROA Y-1 to Y+3), supporting H2d.

Finally, the multivariate analysis of the success of the different deal strategies adopted shows that it is better to perform a deal than do nothing during the first year in office, however the

number of deals performed in the first year is negatively related to CAR Y+2 (Table 10), i.e. it is better to do perform a deal than to do nothing during the first year in office but performing more than one deal is not optimal strategy. As with existing literature, the data results are not clear when determining how many deals is the optimal level of activity during the first year in office, in line with H2e.

*CEO tenure:*

The reason for including CEO tenure as a determinant of company success can be found argued by Henderson et al. (2006) who find that for stable firms the firm-level performance increase with CEO tenure. As the sample of this report consists of large firms included in the main stock index of each country they can be considered as stable, hence a positive relationship between CEO tenure and company performance is expected and confirmed by the regression analysis of the change in profitability (ROA Y-1 to Y+3).

*Company performance pre-succession:*

This control variable represents the starting point for the performance and is expected to have a positive coefficient with the performance post-succession. However, post-succession ROA is positively related to cumulative abnormal returns but it is negatively related to ROA pre-succession. There is evidence supporting a positive relationship between post-succession long-term performance (CAR Y+2) and pre-succession adjusted ROA and ROE.

*Market performance pre-succession:*

Studies have found that deals made in downturns outperform deals made in times of economic boom (Jovanovic and Rousseau, 2001). In addition, Jenter and Kaanan (2006) and Kaplan and Minton (2006) shows that the market is thought to have an impact on the decision of type of CEO succession and type of recruitment, and it could therefore be concluded that the

subsequent performance is also dependent on market behaviour in the year pre-succession. This includes index performance, market volatility and point in the economic cycle (using the Peak-to-Trough method explained in the methodology section). The results confirm the theory of best managerial decisions are taken in downturns, as profitability (ROA Y-1 to Y+3) increase with negative market returns in the year pre-succession, a result also confirmed by studying the negative relationship between profitability and the year of succession being in either ‘the Peak’, ‘the Fall’ or ‘the Recovery’.

#### *Company size at succession:*

If a firm is already large it will have less ability to grow and increase in value, hence the company size is expected to be negatively related to post-succession performance. Freund et al. (2008) argue that overvalued firms are more likely to be bad acquirers. The results provide some evidence with a statistically significant result of a negative relationship between company size and cumulative abnormal returns for the two years following succession.

## **5 Conclusions**

This paper examines CEO turnover and firm performance using a sample of major players in the four largest economies in Europe: France, Germany, Spain, and UK. The findings show that, compared to the CAC 40 and DAX 30, firms listed on the FTSE 100 and IBEX 35 exhibit a higher percentage of both non-routine successions and outside recruitment, indicators of higher surveillance and disciplinary action in the UK and Spain compared to France and Germany. CEOs of UK firms execute more deals than in the other three European countries which could reflect both a more aggressive attitude to deal-making and also differences in legal environment in Europe. Following Rossi and Volpin (2003), strong shareholder protection increases M&A activity, so companies operating under a common law system such as the UK

enjoy higher investor protection rights compared to the other three which operate under a civil law system.

CEOs which have been hired with a ‘mandate to change’ i.e., the succession is forced by the board and the successor is recruited outside the firm (typically correlated events), have higher deal activity during their first year in office, normally as a result of poor performance in the year prior to their appointment. Divestitures are also more likely to be used in cases of poor firm performance or underperformance of the departing CEO compared to board expectations. Newly-appointed CEOs who replace departing CEOs as a result of forced succession or recruiting an ‘outsider’ bring performance improvements.

The results emphasize the impact of institutional investors on deal choice. Strong boards, here proxied by the institutional investors’ ownership, are associated with more intense deal activity in the first year in office of the newly appointed CEO, though they typically favor divestitures over acquisitions. Firm performance in the first two years in office of the newly appointed CEO is positively associated with deal making, in particular with divestitures, though the optimal number of deals remains a less clear issue. The importance of the role of institutional investors in deal making has been increasingly recognized, as the excerpt below brilliantly highlights:

*Forget about trying to spot the next hotshot dealmakers – M&A in 2010 will be driven by the often-faceless shareholder. Bankers say that the biggest worry among acquisitive chief executives at the moment is not how to finance a deal, but how institutional investors will react to it. Their concerns are justified. Long-only institutional shareholders are finally showing willingness to take responsibility for the M&A process, having come to the realisation that scrutiny can affect the value of a company much more than how much the company board is paid... Striking deals won’t be the easy strategy chief executives could turn to just for the sake of it. Shareholders no longer believe visionary chief executives who market their deals with promises of elusive synergies.”*

“Faceless shareholders to drive M&A action, Lina Saigol, The FT, 10 January 2010

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**Table 1: Definition of Variables**

| Type of variable   | Name of variable  | Notes  |
|--|---|--|
| Dependent Variables                                      | Number of Deals 1 Year Post Succession  | Number of deals that a CEO completes during the first year in office   |
|  | Number of Acquisitions 1 Year Post Succession   | Number of acquisitions that the CEO completes during the first year in office  |
|  | Number of Divestitures 1 Year Post Succession   | Number of divestitures that the CEO completes during the first year in office  |
|  | Number of Acquisitions as a Proportion of the Total Number of Deals 1 Year Post Succession                      | Total number of acquisitions as a proportion of the total number of deals that a CEO completes during the first year in office excluding all CEOs who did not perform any deals in the first year.   |
|  | Industry Adjusted ROE from 1 Year Prior to 2 Years Post Succession  | Change in the ratio of Net Income to Shareholders' Equity adjusted to industry median from one year pre-succession to two years post succession  |
|  | Industry Adjusted ROE from 1 Year Prior to 3 Years Post Succession  | Change in the ratio of Net Income to Shareholders' Equity adjusted to industry median from one year pre-succession to three years post succession  |
|  | Industry Adjusted ROA from 1 Year Prior to 2 Years Post Succession  | Change in the ratio of Net Income to Total Assets adjusted to industry median from one year pre-succession to two years post succession  |
|  | Industry Adjusted ROA from 1 Year Prior to 3 Years Post Succession  | Change in the ratio of Net Income to Shareholders' Equity adjusted to industry median from one year pre-succession to three years post succession  |
|  | Cumulative Abnormal Returns 1 Year Post Succession  | Cumulative abnormal return for the period starting at the time of the succession to the first year post succession; it is calculated by adding all the daily abnormal stock price returns of the firm relative to the corresponding index (the index of the stock exchange at which the firm is listed) over the examined period; the abnormal returns are calculated as the difference between the return on the company stock and the return on the market index |
|  | Cumulative Abnormal Returns 2 Years Post Succession   | Cumulative abnormal return for the period starting at the time of the succession to two year post succession   |
| Cumulative Abnormal Returns 3 Years Post Succession      | Cumulative abnormal return for the period starting at the time of the succession to three year post succession  |  |
| Independent and control variables                        | Forced Succession Dummy   | Dummy variable which assumes the value of 1 when the CEO is dismissed or resigns due to disappointing performance or if he or she is in disagreement with the board of directors on key issues   |
|  | External Succession Dummy   | External succession refers to cases where external factors cause changes in current management; examples include a takeover or insolvency procedures where the change in management is forced through by the debtor group or the administrator; the dummy variable equals 1 if the type of succession is external  |
|  | Routine Succession Dummy  | Routine and voluntary turnover includes all 'normal' successions of CEOs due, for example, to retirement or the departure of a CEO at the end of a planned term; the dummy variable equals 1 if the type of succession is routine  |
|  | Inside Recruitment Dummy  | The dummy variable is equal to 1 if the successor of the outgoing CEO is recruited internally and 0 otherwise  |
|  | Outside Recruitment Dummy   | The dummy variable is equal to 1 if the successor of the outgoing CEO is recruited externally and 0 otherwise  |
|  | ROE 1 Year Prior Succession   | The ratio of Net Income to Shareholders' Equity adjusted to industry median one year pre-succession  |
|  | ROA 1 Year Prior Succession   | The ratio of Net Income to Total Assets adjusted to industry median one year pre-succession  |
|  | Cumulative Abnormal Returns 1 Year Prior Succession   | The cumulative abnormal return of the firm one year prior to the CEO succession  |
|  | Stock Market Index Performance 1 Year Prior Succession  | The return on the corresponding index one year prior to the CEO succession   |
|  | Stock Market Volatility 1 Year Prior Succession   | The volatility of the stock market is calculated as the variance of the index returns over one year prior to CEO succession  |
| Institutional Investor Ownership 1 Year Prior Succession | The percentage of the firm shares that is owned by institutional investors one year prior to the CEO succession |  |
| Legal Family: Common Law Dummy                           | The dummy equals 1 if the firm is listed in a common law country and 0 otherwise                                |  |
| Legal Family: Civil Law Dummy                            | The dummy equals to 1 if the firm is listed in a civil law country and 0 otherwise                              |  |

|                                   |                               |  |
|-----------------------------------|-------------------------------|--|
| Independent and control variables | Leverage measure 1            | The ratio of Total debt to Total assets adjusted to industry median one year pre-succession        |
|                                   | Leverage measure 2            | The ratio of Total liabilities to Total assets adjusted to industry median one year pre-succession |
|                                   | Cash flow                     | The ratio of EBTIDA to Sales adjusted to industry median one year pre-succession                   |
|                                   | CEO Tenure                    | Total tenure in days   |
|                                   | CEO Age                       | CEO age at succession  |
|                                   | Market Value (Company size)   | Market value of firm at the day of succession  |
|                                   | Peak-to-trough: Cycle 1 dummy | The time period 'fall' just after a major market peak  |
|                                   | Peak-to-trough: Cycle 3 dummy | The time period 'recovery' just after a major market trough  |
|                                   | Peak-to-trough: Cycle 4 dummy | The time period 'peak' just before and including a major market peak                               |

**Table 2: Sample Characteristics**

| Indices | Number of CEOs | Number of Companies | Forced Succession | Routine Succession | Non routine succession to Total | Inside Recruitment | Outside Recruitment | Outside Recruitment to Total |
|---------|----------------|---------------------|-------------------|--------------------|---------------------------------|--------------------|---------------------|------------------------------|
| CAC40   | 52             | 33                  | 10                | 42                 | 19%                             | 39                 | 13                  | 25%                          |
| DAX 30  | 53             | 35                  | 10                | 43                 | 19%                             | 42                 | 11                  | 21%                          |
| FTSE100 | 195            | 127                 | 46                | 149                | 24%                             | 128                | 67                  | 34%                          |
| IBEX35  | 36             | 22                  | 16                | 20                 | 44%                             | 20                 | 16                  | 44%                          |
| Total   | 336            | 217                 | 82                | 254                | 24%                             | 229                | 107                 | 32%                          |

**Table 3: Sample Descriptives**

| Stock Market Index | Variable  | Mean  | Median | Maximum | Minimum | Standard Deviation | Number of Observations |
|--------------------|---|-------|--------|---------|---------|--------------------|------------------------|
| ALL                | CEOs Age at Appointment                           | 50    | 50     | 73      | 30      | 6                  | 336                    |
|                    | CEOs Total Tenure (in days)                       | 1,702 | 1,558  | 4,549   | 372     | 927                | 336                    |
|                    | Number of Acquisitions                            | 1.34  | 1      | 9       | 0       | 1.83               | 336                    |
|                    | Number of Divestitures                            | 0.78  | 0      | 13      | 0       | 1.64               | 336                    |
|                    | Total Number of deals during tenure               | 2.12  | 1      | 13      | 0       | 2.56               | 336                    |
|                    | Ratio of Total deals to Total years in the office | 0.43  | 0.29   | 3.41    | 0       | 0.5                | 336                    |
| FTSE 100           | CEOs Age at Appointment                           | 49    | 50     | 73      | 30      | 6                  | 195                    |
|                    | CEOs Total Tenure (in days)                       | 1,747 | 1,594  | 4,549   | 380     | 950                | 195                    |
|                    | Number of Acquisitions                            | 1.65  | 1      | 9       | 0       | 2.13               | 195                    |
|                    | Number of Divestitures                            | 0.71  | 0      | 13      | 0       | 1.68               | 195                    |
|                    | Total Number of deals during tenure               | 2.36  | 2      | 13      | 0       | 2.67               | 195                    |
|                    | Ratio of Total deals to Total years in the office | 0.49  | 0.35   | 3.41    | 0       | 0.56               | 195                    |
| CAC                | CEOs Age at Appointment                           | 52    | 52     | 63      | 36      | 7                  | 52                     |
|                    | CEOs Total Tenure (in days)                       | 1,687 | 1,510  | 4,119   | 372     | 912                | 52                     |
|                    | Number of Acquisitions                            | 1.15  | 1      | 6       | 0       | 1.44               | 52                     |
|                    | Number of Divestitures                            | 0.83  | 0      | 6       | 0       | 1.53               | 52                     |
|                    | Total Number of deals during tenure               | 1.98  | 1      | 8       | 0       | 2.24               | 52                     |
|                    | Ratio of Total deals to Total years in the office | 0.4   | 0.32   | 1.93    | 0       | 0.46               | 52                     |
| DAX                | CEOs Age at Appointment                           | 52    | 54     | 60      | 37      | 5                  | 53                     |
|                    | CEOs Total Tenure (in days)                       | 1,622 | 1,627  | 3,699   | 395     | 914                | 53                     |
|                    | Number of Acquisitions                            | 1.02  | 0      | 7       | 0       | 1.58               | 53                     |
|                    | Number of Divestitures                            | 1.11  | 0      | 7       | 0       | 1.7                | 53                     |
|                    | Total Number of deals during tenure               | 2.13  | 1      | 13      | 0       | 2.72               | 53                     |
|                    | Ratio of Total deals to Total years in the office | 0.42  | 0.29   | 1.86    | 0       | 0.43               | 53                     |
| IBEX               | CEOs Age at Appointment                           | 51    | 51     | 64      | 40      | 6                  | 36                     |
|                    | CEOs Total Tenure (in days)                       | 1,664 | 1,592  | 4,508   | 420     | 907                | 36                     |
|                    | Number of Acquisitions                            | 0.91  | 0      | 4       | 0       | 1.2                | 36                     |
|                    | Number of Divestitures                            | 0.59  | 0      | 8       | 0       | 1.59               | 36                     |
|                    | Total Number of deals during tenure               | 1.5   | 1      | 10      | 0       | 2.32               | 36                     |
|                    | Ratio of Total deals to Total years in the office | 0.31  | 0.08   | 1.36    | 0       | 0.41               | 36                     |

**Table 4: Univariate Analysis Number of Deals 1 Year Post Succession**

Panel A: Sub-sample Characteristics

| <b>Variable</b>     | <b>Mean</b> | <b>Number<br/>of Observations</b> |
|---------------------|-------------|-----------------------------------|
| Forced Succession   | 0.745       | 51                                |
| External Succession | 0.500       | 16                                |
| Routine Succession  | 0.403       | 196                               |
| Inside Recruitment  | 0.415       | 213                               |
| Outside Recruitment | 0.619       | 64                                |

Panel B: Univariate Mean Tests

| <b>Type of Test</b>     | <b>Difference in Mean</b> | <b>(p-value)</b> |
|-------------------------|---------------------------|------------------|
| Forced versus External  | 0.245                     | 0.4183           |
| External versus Routine | 0.097                     | 0.645            |
| Routine versus Forced   | -0.342                    | 0.013            |
| Insider versus Outsider | -0.204                    | 0.096            |



**Table 5: Correlation Analysis – Number of Deals 1 Year Post Succession**

| Variable  | Number of Deals (1 Year Post Succession) | Forced Succession Dummy | Outside Recruitment Dummy | Industry Adjusted ROA (1 Year Prior Succession) | Cumulative Abnormal Return (1 Year Prior Succession) | Stock Market Index Performance (1 Year Prior Succession) | Stock Market Volatility (1 Year Prior Succession) | Institutional Investor Ownership (1 Year Prior Succession) | Legal Family: Common Law Dummy |
|---|--|-------------------------|---------------------------|---|--|--|---|--|--------------------------------|
| <b>Number of Deals (1 Year Post Succession)</b>                   | 1.000                                    | 0.154                   | 0.100                     | -0.059  | -0.155   | -0.046   | -0.055  | 0.121  | 0.059                          |
| <b>p-value</b>  |  | 0.011                   | 0.096                     | 0.345   | 0.014  | 0.451  | 0.362   | 0.072  | 0.332                          |
| <b>Forced Succession Dummy</b>                                    | 0.154                                    | 1.000                   | 0.121                     | -0.199  | -0.200   | -0.106   | 0.081   | 0.032  | -0.032                         |
| <b>p-value</b>  | 0.011                                    |                         | 0.047                     | 0.002   | 0.001  | 0.081  | 0.181   | 0.633  | 0.602                          |
| <b>Outside Recruitment Dummy</b>                                  | 0.100                                    | 0.121                   | 1.000                     | -0.104  | -0.128   | -0.045   | 0.015   | 0.123  | 0.064                          |
| <b>p-value</b>  | 0.096                                    | 0.047                   |                           | 0.099   | 0.042  | 0.462  | 0.800   | 0.067  | 0.287                          |
| <b>Industry Adjusted ROA (1 Year Prior Succession)</b>            | -0.059                                   | -0.199                  | -0.104                    | 1.000   | 0.127  | -0.005   | -0.057  | 0.059  | 0.054                          |
| <b>p-value</b>  | 0.346                                    | 0.002                   | 0.099                     |   | 0.051  | 0.933  | 0.369   | 0.395  | 0.394                          |
| <b>Cumulative Abnormal Return (1 Year Prior Succession)</b>       | -0.155                                   | -0.200                  | -0.128                    | 0.127   | 1.000  | 0.034  | -0.065  | 0.104  | 0.059                          |
| <b>p-value</b>  | 0.014                                    | 0.001                   | 0.042                     | 0.051   |  | 0.590  | 0.303   | 0.125  | 0.350                          |
| <b>Stock Market Index Performance (1 Year Prior Succession)</b>   | -0.046                                   | -0.106                  | -0.045                    | -0.005  | 0.034  | 1.000  | -0.612  | -0.040   | -0.086                         |
| <b>p-value</b>  | 0.451                                    | 0.081                   | 0.462                     | 0.933   | 0.590  |  | 0.000   | 0.549  | 0.155                          |
| <b>Stock Market Volatility (1 Year Prior Succession)</b>          | -0.055                                   | 0.081                   | 0.015                     | -0.057  | -0.065   | -0.612   | 1.000   | -0.167   | -0.299                         |
| <b>p-value</b>  | 0.362                                    | 0.181                   | 0.800                     | 0.369   | 0.303  | 0.000  |   | 0.013  | 0.000                          |
| <b>Institutional Investor Ownership (1 Year Prior Succession)</b> | 0.121                                    | 0.032                   | 0.123                     | 0.059   | 0.104  | -0.040   | -0.167  | 1.000  | 0.546                          |
| <b>p-value</b>  | 0.072                                    | 0.633                   | 0.067                     | 0.395   | 0.125  | 0.549  | 0.013   |  | 0.000                          |
| <b>Legal Family: Common Law Dummy</b>                             | 0.059                                    | -0.032                  | 0.064                     | 0.054   | 0.059  | -0.086   | -0.299  | 0.546  | 1.000                          |
| <b>p-value</b>  | 0.332                                    | 0.602                   | 0.287                     | 0.394   | 0.350  | 0.155  | 0.000   | 0.000  |                                |

**Table 6: Correlation Analysis – Number of Acquisitions as a Proportion of Total Number of Deals (1 Year Post Succession)**

| Variable  | Proportion of Acquisitions (1 Year Post Succession) | Forced Succession Dummy | External Succession Dummy | Industry Adjusted ROE (1 Year Prior Succession) | Cumulative Abnormal Return (1 Year Prior Succession) | Stock Market Index (1 year Prior Succession) | Stock Market volatility (1 Year Prior Succession) | Institutional investor Ownership (1 Year Prior Succession) | Legal Family: Common Law Dummy |
|---|---|-------------------------|---------------------------|---|--|--|---|--|--------------------------------|
| <b>Proportion of Acquisitions (1 Year Post Succession)</b>        |   | -0.240                  | 0.072                     | -0.034  | 0.296  | 0.185  | -0.001  | -0.243   | -0.105                         |
| <b>p-value</b>  |   | 0.033                   | 0.529                     | 0.763   | 0.010  | 0.103  | 0.995   | 0.043  | 0.357                          |
| <b>Forced Succession Dummy</b>                                    | -0.240  |                         | -0.156                    | -0.193  | -0.168   | -0.260                                       | 0.223   | 0.067  | -0.188                         |
| <b>p-value</b>  | 0.033   |                         | 0.169                     | 0.089   | 0.147  | 0.021  | 0.049   | 0.580  | 0.098                          |
| <b>External Succession Dummy</b>                                  | 0.072   | -0.156                  |                           | 0.031   | -0.072   | -0.063                                       | -0.006  | 0.165  | 0.125                          |
| <b>p-value</b>  | 0.529   | 0.169                   |                           | 0.789   | 0.536  | 0.580  | 0.958   | 0.173  | 0.271                          |
| <b>Industry Adjusted ROE (1 Year Prior Succession)</b>            | -0.034  | -0.193                  | 0.031                     |   | 0.263  | 0.218  | -0.305  | 0.094  | 0.143                          |
| <b>p-value</b>  | 0.763   | 0.089                   | 0.789                     |   | 0.022  | 0.054  | 0.006   | 0.439  | 0.210                          |
| <b>Cumulative Abnormal Returns (1 Year Prior Succession)</b>      | 0.296   | -0.168                  | -0.072                    | 0.263   |  | 0.295  | -0.271  | 0.216  | 0.163                          |
| <b>p-value</b>  | 0.010   | 0.147                   | 0.536                     | 0.022   |  | 0.010  | 0.018   | 0.077  | 0.159                          |
| <b>Stock Market Index Performance (1 Year Prior Succession)</b>   | 0.185   | -0.260                  | -0.063                    | 0.218   | 0.295  |  | -0.673  | -0.030   | 0.024                          |
| <b>p-value</b>  | 0.103   | 0.021                   | 0.580                     | 0.054   | 0.010  |  | 0.000   | 0.807  | 0.834                          |
| <b>Stock Market volatility (1 Year Prior Succession)</b>          | -0.001  | 0.223                   | -0.006                    | -0.305  | -0.271   | -0.673                                       |   | -0.234   | -0.278                         |
| <b>p-value</b>  | 0.995   | 0.049                   | 0.958                     | 0.006   | 0.018  | 0.000  |   | 0.052  | 0.013                          |
| <b>Institutional investor Ownership (1 Year Prior Succession)</b> | -0.243  | 0.067                   | 0.165                     | 0.094   | 0.216  | -0.030                                       | -0.234  |  | 0.453                          |
| <b>p-value</b>  | 0.043   | 0.580                   | 0.173                     | 0.439   | 0.077  | 0.807  | 0.052   |  | 0.000                          |
| <b>Legal Family: Common Law Dummy</b>                             | -0.105  | -0.188                  | 0.125                     | 0.143   | 0.163  | 0.024  | -0.278  | 0.453  |                                |
| <b>p-value</b>  | 0.357   | 0.098                   | 0.271                     | 0.210   | 0.159  | 0.834  | 0.013   | 0.000  |                                |

**Table 7: Regression Analysis with Deal Activity as the Dependent Variable**

| <b>Dependent Variable: Number of Deals (1 Year Post Succession)</b> |                    | <b>Model (1) - All</b> |                    | <b>Model (2) - Significant</b> |  |
|---|--------------------|------------------------|--------------------|--------------------------------|--|
| <b>Independent Variables</b>  | <b>Coefficient</b> | <b>p- Value</b>        | <b>Coefficient</b> | <b>p-Value</b>                 |  |
| CONSTANT  | -0.134             | 0.950                  | 0.318              | 0.004                          |  |
| Forced Succession Dummy   | 0.417              | 0.023                  | 0.426              | 0.014                          |  |
| External Succession Dummy   | 0.204              | 0.518                  |                    |                                |  |
| Outside Recruitment Dummy   | 0.170              | 0.306                  |                    |                                |  |
| ROE (1 Year Prior Succession)                                       | 0.009              | 0.876                  |                    |                                |  |
| ROA (1 Year Prior Succession)                                       | -0.809             | 0.435                  |                    |                                |  |
| Leverage Measure 1 (1 Year Prior Succession)                        | -0.439             | 0.398                  |                    |                                |  |
| Leverage Measure 2(1 Year Prior Succession)                         | 0.552              | 0.327                  |                    |                                |  |
| Cumulative Abnormal Return (1 Year Prior Succession)                | -0.635             | 0.013                  | -0.586             | 0.017                          |  |
| Institutional Investor Ownership (1 Year Prior Succession)          | 0.004              | 0.132                  | 0.005              | 0.043                          |  |
| Legal Family: Common Law Dummy                                      | 0.050              | 0.760                  |                    |                                |  |
| Log (CEO Age)   | 0.319              | 0.800                  |                    |                                |  |
| Log (Market Value)  | +0.189             | 0.00812                | 0.208              | 0.072                          |  |
| Cash Flow (1 Year Prior Succession)                                 | 0.819              | 0.140                  |                    |                                |  |
| <b>Sample Size</b>  | <b>401</b>         |                        | <b>401</b>         |                                |  |
| <b>R<sup>2</sup></b>  | <b>12.27%</b>      |                        | <b>8.61%</b>       |                                |  |
| <b>F-Ratio</b>  | <b>1.90</b>        | <b>(0.032)</b>         | <b>5.87</b>        | <b>(0.001)</b>                 |  |

**Table 8: Regression Analysis with Acquisition Activity as the Dependent Variable**

| Dependent Variable: Number of Acquisitions (1 Year Post Succession) | Model (1) - All |                | Model (2)-Significant |                |
|---|-----------------|----------------|-----------------------|----------------|
|   | Coefficient     | p-Value        | Coefficient           | p-Value        |
| Independent variables   |                 |                |                       |                |
| CONSTANT  | -1.214          | 0.497          | 0.768                 | 0.000          |
| Forced Succession Dummy   | -0.125          | 0.366          |                       |                |
| External Succession Dummy   | 0.311           | 0.197          |                       |                |
| Outside Recruitment Dummy   | 0.000           | 0.999          |                       |                |
| ROE (1 Year Prior Succession)                                       | -0.670          | 0.066          |                       |                |
| ROA (1 Year Prior Succession)                                       | 1.001           | 0.283          |                       |                |
| Leverage Measure 1 (1 Year Prior Succession)                        | 0.516           | 0.377          |                       |                |
| Leverage Measure 2 (1 Year Prior Succession)                        | 0.120           | 0.802          |                       |                |
| Cumulative Abnormal Returns (1 Year Prior Succession)               | 0.396           | 0.049          | 0.341                 | 0.046          |
| Institutional Investor Ownership (1 Year Prior Succession)          | -0.004          | 0.046          | -0.004                | 0.008          |
| Legal Family: Common Law Dummy                                      | 0.078           | 0.560          |                       |                |
| Log (CEO Age)   | 0.993           | 0.342          |                       |                |
| Log (Market Value)  | 0.053           | 0.662          |                       |                |
| Cash Flow (1 Year Prior Succession)                                 | 0.721           | 0.105          | 0.656                 | 0.066          |
| <b>Sample size</b>  | <b>272</b>      |                | <b>272</b>            |                |
| <b>R<sup>2</sup></b>  | <b>11.69%</b>   |                | <b>13.41%</b>         |                |
| <b>F-Ratio</b>  | <b>1.78</b>     | <b>(0.072)</b> | <b>4.51</b>           | <b>(0.003)</b> |

**Table 9: Regression Analysis with Change in ROA from 1 Year Prior to 3 Years Post Succession as the Dependent Variable**

| Dependent Variable: ROA from 1 Year Prior to 3 Years Post Succession | Model (1) - All |                | Model (2) - Significant |                |
|--|-----------------|----------------|-------------------------|----------------|
|  | Coefficient     | p-Value        | Coefficient             | p-Value        |
| Independent Variables  |                 |                |                         |                |
| CONSTANT   | -0.237          | 0.152          | -0.212                  | 0.100          |
| Log (CEO Tenure)   | 0.032           | 0.115          | 0.029                   | 0.086          |
| More Than 0 Deals Dummy  | -0.014          | 0.576          |                         |                |
| Number Deals   | 0.009           | 0.451          |                         |                |
| Number Acquisitions  | -0.009          | 0.534          |                         |                |
| Forced Succession Dummy  | 0.013           | 0.367          |                         |                |
| External Succession Dummy  | -0.004          | 0.925          |                         |                |
| Outside Recruitment Dummy  | 0.020           | 0.132          | 0.027                   | 0.016          |
| Institutional Investor Ownership (1 Year Prior Succession)           | 0.000           | 0.140          | 0.000                   | 0.104          |
| ROE (1 Year Prior Succession)  | 0.008           | 0.667          |                         |                |
| ROA (1 Year Prior Succession)  | -0.027          | 0.052          | -0.019                  | 0.049          |
| Cumulative Abnormal Returns (1 Year Prior Succession)                | 0.774           | 0.000          | 0.782                   | 0.000          |
| Market Returns (1 Year Prior Succession)                             | -0.046          | 0.084          | -0.029                  | 0.090          |
| Volatility   | 0.019           | 0.362          |                         |                |
| Cash Flow (1 Year Prior Succession)                                  | -0.068          | 0.048          | -0.065                  | 0.030          |
| Log (Market Value)   | 0.003           | 0.780          |                         |                |
| Peak-to-trough: Cycle 1 Dummy  | -0.029          | 0.179          |                         |                |
| Peak-to-trough: Cycle 2 Dummy  | -0.031          | 0.115          |                         |                |
| Peak-to-trough: Cycle 3 Dummy  | -0.040          | 0.013          | -0.024                  | 0.015          |
| <b>Sample size</b>   | <b>230</b>      |                | <b>230</b>              |                |
| <b>R<sup>2</sup></b>   | <b>11.46%</b>   |                | <b>12.55%</b>           |                |
| <b>F-Ratio</b>   | <b>10.10</b>    | <b>(0.000)</b> | <b>13.26</b>            | <b>(0.000)</b> |

**Table 10: Regression Analysis with Change in Cumulative Abnormal Returns 2 Years Post Succession as the Dependent Variable**

| Dependent Variable: Cumulative Abnormal Return<br>(2 Years Post Succession) | Model (1) - All |                | Model (2) - Significant |                |
|---|-----------------|----------------|-------------------------|----------------|
|   | Coefficient     | p-Value        | Coefficient             | p-Value        |
| CONSTANT  | 0.097           | 0.867          | -0.004                  | 0.883          |
| Log (CEO Tenure)  | 0.022           | 0.743          |                         |                |
| More Than 0 Deals Dummy   | 0.229           | 0.030          | 0.266                   | 0.001          |
| Number of Deals   | -0.099          | 0.051          | -0.113                  | 0.007          |
| Number of Acquisitions  | 0.025           | 0.674          |                         |                |
| Forced Succession Dummy   | -0.075          | 0.218          |                         |                |
| External Succession Dummy   | -0.013          | 0.926          |                         |                |
| Outside Recruitment Dummy   | 0.121           | 0.026          | 0.096                   | 0.032          |
| Institutional Investor Ownership (1 Year Prior Succession)                  | 0.000           | 0.962          |                         |                |
| ROE (1 Year Prior Succession)   | 0.356           | 0.000          | 0.405                   | 0.000          |
| ROA (1 Year Prior Succession)   | 0.083           | 0.142          | 0.084                   | 0.015          |
| Cumulative Abnormal Returns (1 Year Prior Succession)                       | 0.380           | 0.244          |                         |                |
| Market Returns (1 Year Prior Succession)                                    | 0.489           | 0.000          | 0.507                   | 0.000          |
| Volatility  | -0.036          | 0.659          |                         |                |
| Cash Flow (1 Year Prior Succession)   | 0.108           | 0.450          |                         |                |
| Log (Market Value)  | -0.057          | 0.226          |                         |                |
| Peak-to-trough: Cycle 1 Dummy   | 0.074           | 0.339          | 0.111                   | 0.046          |
| Peak-to-trough: Cycle 2 Dummy   | -0.081          | 0.315          |                         |                |
| Peak-to-trough: Cycle 3 Dummy   | -0.033          | 0.545          |                         |                |
| <b>Sample size</b>  | <b>101</b>      |                | <b>101</b>              |                |
| <b>R<sup>2</sup></b>  | <b>18.12%</b>   |                | <b>19.02%</b>           |                |
| <b>F-Ratio</b>  | <b>14.79</b>    | <b>(0.000)</b> | <b>19.29</b>            | <b>(0.000)</b> |