Should They Stay or Should They Go?

CEO Appointments and Performance in a Transitional Economy

by

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Abstract

This study examines corporate operating performance surrounding chief executive officer (CEO) appointments for a sample of 1,015 such appointments from January 2001 through December 2013 to firms listed on the Warsaw Stock Exchange. We observe that firms perform significantly better in the case of reappointments compared to CEO replacements. We find that operating performance deteriorates over the three years preceding CEO turnovers as well as re-appointments. Our findings are consistent with weakness in the governance mechanisms for firms in emerging markets.

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1. Introduction

The spectacular failures of Enron and WorldCom in which the main perpetrators were senior management members acting against their shareholders, exposed significant failures in the governance processes and practices of these firms. The response to the collapse of these major firms was both rapid and global in nature. Multiple nations implemented regulatory reforms designed to strengthen their internal governance structures and to improve the protections afforded minority shareholders. With these changes, the role of the CEO has become even more central to effective corporate governance (Shen and Cannella, 2002; Huson et al., 2004; Finkelstein et al., 2009; Fahlenbrach et al., 2010).

Unfortunately, in a modern corporation with its separation of ownership and control functions (Jensen, 1986), it is not possible to completely prevent CEOs from undertaking actions which destroy shareholder value. The literature on corporate agency theory describes a number of governance mechanisms that can reduce information asymmetry, constrain opportunistic behaviour by managers, and align shareholder/manager interests (Jensen and Meckling, 1976; Fama, 1980; and Fama and Jensen, 1983).

Denis and Denis (1995) observe that the appointment of a CEO by a board is one of the strongest mechanisms for corporate governance. They observe that removal of poorly performing CEOs is a critical step towards the maximization of shareholder wealth. They argue that when a firm's governance is effective, the frequency of CEO turnover is higher in poorly performing firms. As a consequence, improvements in operating performance following management changes are achieved. This result is also consistent with work in labor economics by Jovanovic (1979) and McNeilo et al (2004).

As suggested by Denis and Denis (1995), the present literature examines the effectiveness of corporate governance by emphasizing CEO removals. Rarely are CEO re-appointment decisions analysed. In this study we contribute to the literature by analysing not only new appointments, but also CEO reappointments. Hence, the research goal of this study is to assess the valuation and performance results associated with CEO appointments as well as reappointments.

We believe that there are several reasons why an analysis of CEO reappointment decisions are important to a fuller understanding of corporate governance practices. A reappointment indicates that the firm is likely to continue its current business strategy and operating procedures. It is a signal of continuity of the organization's practices and the board's satisfaction with the firm's performance. On a related basis, the reappointment will be seen by investors that a significant change in the firm's profitability, earnings, or other performance measures is unlikely. Finally, the reappointment decision represents an opportunity cost for the board. That is, a new CEO is not selected. The decision not to hire a new CEO should be justifiable based on the firm's performance to date (Jenter et al., 2016: Rivolta, 2018). A less favourable interpretation of the reappointment decision from the prospective of shareholders, is that it reflects managerial power and entrenchment (Bebchuk and Fried, 2003).

This study is the first to examine the relation between CEO appointments and corporate performance in a post-Socialist economy. The current literature primarily emphasizes developed markets and Western corporate governance systems. Our study with its sample of 1,015 Polish CEO appointments, allows us to examine the efficiency of the CEO labor market in a former Socialist economy. This study bridges a research gap with its focus on a post-Communist market.

The managerial labour market in Socialist economies was characterized by limited autonomy with success measured by an ability to fulfill plans rather than relevant industry

experience (Jones and Kato, 1996; Linz, 1988). Since 1989, these Socialist economies have been transitioning to free markets, resulting in firms with new ownership and governance structures. But due to the rapid pace of economic transformation as well as the lack of market-experienced managers, this transition has faced problems, including the classic agency conflict between managers and owners. With our focus on CEO appointments in these transitioning economies, our study provides a needed extension to the work of Ballinger and Marcel (2010), Masulis *et al*. (2012), and Jermias and Gani (2014) who establish the criticality of the CEO to corporate profitability and success in transition economies.

The remainder of our study proceeds as follows. Section 2 presents the development of our research hypotheses. In Section 3 we describe our data and the sample construction process. Section 4 presents our sample characteristics and initial empirical analysis. In Section 5 we discuss our major findings regarding firm performance and CEO appointments. In Section 6 we further test the relation between firm performance and CEO appointments by estimating a logit model for CEO turnover. We provide a set of robustness estimations in Section 7. We conclude with a summary and discussion of the importance of our findings in Section 8.

2. Hypothesis Development

Denis and Denis (1995) contend that removal of a poorly performing CEO is one of the most effective internal mechanisms to mitigate agency conflict within the firm. Studies such Coughlan and Schmidt (1985), Denis and Denis (1995), Dedman and Lin (2002), Huson *et al*. (2004), Hillier *et al*. (2005) and Fisman *et al*. (2013) show that CEO turnover is preceded by deteriorating operating performance. Boards of directors monitor the CEO's performance and replace those who fail to meet expectations. Farrell and Whidbee (2003) note that boards tend to focus on deviations from expected results rather than performance per se when deciding on a CEO replacement. Jenter and Kannan (2015) argue that CEO replacement can also occur

when poor corporate performance is due to independent phenomena such as industry shocks, technological disruption, or market-wide forces. McNeil et al. (2004) report that subsidiary manager turnover is highly sensitive to performance and more likely following poor performance than that of CEOs. Based on the disciplining nature of a CEO replacement, we hypothesize:

H1a: CEO replacements are preceded by a decline in the firm's operating performance.

The existing corporate governance literature focuses on the CEO's replacement. Studies examine issues such as the relation between performance and the decision to terminate, the ability of entrenched CEOs to persist regardless of performance, and the valuation effects of voluntary vs forced executive turnover. There are no studies which specifically examine the operating and valuation effects of CEO reappointment. The literature has emphasized CEO turnover, not CEO retention and continuity.

To the extent that a board is independent of management and focused on shareholder wealth maximization, it will provide a robust monitoring of the CEO. Consequently, reappointment decisions are affected by the firm's performance observed in the period prior to the reappointment decision. Investors are influenced by the firm's recent share price and communicate their assessment of the firm's prospects to the capital market through buy and sell activity. Thus, it is unlikely that poorly performing CEOs are reappointed. CEOs who create value for shareholders are seen as most valuable by independent boards. Consequently, we hypothesize:

H1b: CEO re-appointments are preceded by a stable or increasing level of operating performance.

Denis and Denis (1995) argue that if a firm's corporate governance is effective, then its operating performance will improve subsequent to a CEO's replacement. This occurs since new CEOs will be selected on the basis of their ability to enhance shareholder wealth. This implies

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that a board identifies another CEO whose expected quality exceeds that of the predecessor. They find that a change in CEOs is followed by a significant improvement in the firm's operating performance. Denis and Denis report that as a consequence of forced resignations, firms significantly downsize their operations while increasing their profitability and operating efficiency. Similar evidence is reported by Huson *et al.* (2004) who show that managerial quality and firm operating performance substantially improve after CEO turnover.

There are also several theories drawn from the management literature that suggest a performance improvement following CEO replacement. The Ability Hypothesis assumes that quality varies across managers and that the goal of boards is to select the most talented executives (Murphy and Zábojník, 2004; Chang et al., 2010; Baik et al., 2011; Pessarossi and Weill, 2013). Hence, operating performance should improve following CEO replacement. The Improved Management Hypothesis assumes that the abilities of CEOs vary. If the firm's performance is substantially poor, another more qualified manager is appointed as a replacement. Consequently, future performance is expected to improve following a change in management (Huson et al., 2004). Finally, according to the Common-Sense Hypothesis, a firm's performance should improve whenever an inefficient CEO is replaced with a more effective individual (Grusky, 1963; Helmich, 1974; Allen et al., 1979; Daltaon and Kesner, 1985; Kesner and Sebora, 1994). Consequently, we hypothesize:

H2a: A firm's operating performance improves following the replacement of the incumbent CEO.

Given this literature and assuming that internal corporate governance mechanisms are effective in monitoring management, we contend that CEO reappointments will also be associated with strong corporate performance. Independent and effective supervisory board will only reappoint CEOs who have demonstrated an ability to create shareholder value during their

tenure. Thus, they are likely to continue the policies, strategies, and approaches that generated corporate value during their initial appointment. Therefore, we hypothesize:

H2b: A firm's operating performance improves following the reappointment of its CEO.

3. Sample Construction and Data

3.1 Sample Identification

The sample construction process occurs in several steps. First, we identify a comprehensive sample of CEO appointments in non-financial firms traded on the main floor of the Warsaw Stock Exchange (WSE) over the years 2000 through 2015. We achieve this by searching the newswires of *GPWinfoStrefa.* This search results in an initial sample of 10,000 press releases that relate to CEO appointments over the years 2005 to 2015. Next, from the Polish Financial Supervision Authority and commercial business services we identify other CEO appointments that occur prior to the year 2005. We also add announcements regarding CEO appointments from the *Notoria On-Line Service.* We then edit this augmented initial sample by eliminating the following appointments: (1) temporary CEO appointments, (2) appointments to a foreign firm, and (3) appointments with incomplete details. Application of these filters produces an intermediate sample of 2,033 CEO appointments over our sample period.

We then apply a final filter involving the availability of financial and accounting data. To undertake our comparative performance analysis, we require financial and accounting data for three years pre and post relative to the year of the CEO's appointment. This requirement further reduces the sample size, resulting in a final sample of 1,015 CEO appointments over the period January 2001 to December 2013. The sample is distributed between 505 CEO replacement appointments and 510 re-appointments.

3.2 Data

To undertake our analysis of changes in corporate operating performance surrounding a CEO appointment, we require annual corporate accounting data. We obtain annual accounting data for firms from the *Notoria Service* database for the period 1997 to 2016. To control for industry effects, we obtain annual industry data from *InfoCredit* service which provides accounting and financial data for firms operating in the Polish market. Because of limitations regarding the availability of industry data, we are forced to further trim our sample for certain analyses. In our subsequent multivariate analysis, we are limited to a sample of 964 events which consist of 473 CEO replacements and 491 reappointments.

4. Sample Characteristics and Initial Empirical Analysis

In this section we first provide a description of key univariate sample statistics. We then provide our major multivariate tests regarding the hypotheses developed in Section 2.

4.1 Year and Industry Distribution of the Sample

Our initial sample consists of 1,015 CEO appointments distributed between 510 reappointments (50.25%) and 505 (49.75%) CEO replacements over the years 2001 to 2013. We observe that the number of CEO appointments (both reappointments and replacements) increases annually. There are 23 appointment events in 2001, but there are almost six times more appointments in 2013. There are two possible reasons for this upward trend in our data. First, the number of firms quoted on the Warsaw Stock Exchange has almost doubled since the start of our sample period. Second, beginning in 2005 corporate public announcements became available in a comprehensive database with the implementation of the ESPI system.[1]

Figure 1 and Panel A of Table 1 shows the distribution of CEO replacements and reappointments over the sample period. We observe that in 2003 and in the post crisis period

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[1] ESPI (Elektroniczny System Przekazywania Informacji) which is the IT system that allows immediate transfer and publication of corporate announcements.

starting from 2009, the number of CEO reappointments generally exceeds the number of CEO replacements. Beginning in 2009, Polish firms appear to prefer insiders and are more likely to reappoint their CEOs for another term. Until the world financial crisis of 2008, boards of directors more often replaced CEOs and appointed a new executive.[2] The financial crisis increased uncertainty in the worldwide financial markets as well as in the Polish capital market.[3] We conclude that as the external environment became less predictable, Polish boards decided to stabilize their corporate leadership by increasing reappointments and reducing the number of replacements.

Panel B contains the distribution of the sample across various industries. Our results suggest that there are strong industry patterns in our data. Approximately 81% of the sample events are concentrated in three industries: building, industry, and services. The remainder of our sample is in the finance, trade, or unidentified sectors. The distribution across industries between replacements and replacements is approximately equivalent. There is a slight tendency, however, for the finance, industry, and unidentified sectors to replace their CEOs rather than reappoint.

Table 2 contains various demographic characteristics of our sample CEOs. Panel A shows that only 4.3% of the CEOs are female while over 73% are insider candidates (Panel B). Panels C and D show that 92.2% of the CEOs have prior managerial experience and 94.5% have industry experience, respectively. Panel E shows that only 20.7% of the CEOs have elite education which we define as an MBA or a PhD. We observe in Panel F that the average CEO is 46 years old, with reappointed CEOs slightly older at 48 years. Panel G shows that reappointed CEOs have a mean tenure in office of 2.65 years, while replacement CEOs as

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[2] Note that the financial crisis did not affect the Polish economy and companies as much as other countries in the world. The decline in the WIG index was observed from late summer in 2007 and lasted until the beginning of 2009.

[3] Activity in the Polish equity market is captured by the WIG (*Warszawski Indeks Giełdowy*) which is the oldest index of the Warsaw Stock Exchange.

expected, have a lower tenure at 1.87 years. Panel H further shows that replacement CEOs are new to their positions with a cumulative tenure of only 1.88 years. This contrasts to 4.82 years for reappointed CEOs. This suggests that for most of the replacement CEOs, that this is their first appointment as a CEO.

In Table 3 we provide further descriptive statistics for select variables associated with this initial descriptive analysis. The management boards of our sample firms are very small, with an average size of only 3. The mean board size is not significantly different between firms that replace or reappoint their CEOs. This small average size of our boards might explain the evidence of weak corporate governance we obtain later in this study.

We also compare two important accounting characteristics between our sample firms. Surprisingly, there is not much difference in the sales level between firms that replace their CEOs and those that reappoint them. This suggests that the firms are of equivalent size regardless of whether they experience a reappointed or new CEO. Nor is there any meaningful difference in the use of debt between these two sets of firms.

4.2 Insider and Outsider Status

In Table 4 we conclude our descriptive analysis of the sample by examining the extent to which insider or outsider status influences the appointment decision, specifically the replacement decision. In Table 4 we examine the transition of replacement CEOs between insider and outsider status. We begin by considering the status of the incumbent. We find that insider CEOs are slightly more often replaced by CEOs originating from outside the firm. That is, 55.22 of the successors to insider CEOs come from new organizations. Only 44.8% are insiders. When the incumbent is an outsider, then it is even more likely that the replacement will be an outsider as well. In these cases, 61.2% of the successors are outsiders and only 38.8% are insiders.

We then examine if the nature of the CEO's departure influences the insider or outsider origin of the successor CEO. More specifically, we investigate whether forced or voluntary CEO departures make a difference.[4] We observe that forced departures are associated with a marginally higher percentage of outside replacement CEOs than voluntary departures. Nearly 58% of the successor CEOs following a forced departure are outsiders compared to 52% for voluntary departures. This increased hiring of outsiders is consistent with the demand for a fresh start and independence that often accompanies the forced removal of a CEO.

5. Firm Performance and CEO Appointments

In this section we begin our analysis of firm performance in response to a CEO appointment. We begin with the immediate capital market effect to the announcement of the appointment. We then examine the subsequent longer-term operating performance following the appointment.

5.1 Event Study Analysis

In Table 5 we report the announcement period CARs for a three day widow surrounding the event (i.e., day 0 to day 2). Although all of the CARs are negative, we observe that the CARs are less negative for the replacement appointments. These findings lead to several conclusions regarding the market's response to news about a CEO appointment. The uniform negative response to the announcement implies that the market does not anticipate value creation changes to occur as a result of the appointment. But the market is less negative about replacement appointments. This seems to suggest that investors have a limited expectation of

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[4] To classify CEO departures as forced, we follow the methodology of Parrino (1997). That is, departures are viewed as forced if business and trade press reports identify them as due to a firing, resignation, death, or end of term resignation. Because press reports regarding CEO departures are relatively few, we also use age as a basis to identify forced resignations. Resignations of CEOs less than 60 year old (female) and 65 (males) are classified as forced. All departures not classified as forced are viewed as voluntary.

performance improvement as the result of a new CEO. Overall, the event study analysis indicates that the market does not view the CEO appointment process as a useful response to the performance issues facing the firm.

5.2 Changes in Operating Performance Surrounding CEO Appointments

To assess whether the board's decision about replacing or reappointing the CEO reflects good governance from a shareholder value perspective, we examine corporate operating performance for seven years centred around the year of the CEO appointment. We examine firm operating performance by measuring changes in its operating return on assets (OROA). OROA is defined as the ratio of operating income before depreciation to the book value of total assets. Because OROA is a scaled measure of operating profit, it allows us to control for size differences across firms as well as changes in asset value within firms during our sample period (Denis and Denis, 1995).

In Table 6 we examine changes in the OROA surrounding CEO appointments. We use both the Fahlenbrach *et al.* (2010) and the Huson *et al.* (2004) approach to measure our changes.[5] We calculate both a raw and an industry-adjusted measure of OROA, but only report the more complete industry-adjusted results. The results using the unadjusted measures are qualitatively identical and provide no additional insights.

In Panel A we use the Fahlenbrach et al. (2010) approach to measure the change in OROA. We compare the change in mean (median) OROA across the pre-period (i.e., year -3 to year -1) to that calculated over the post-period (i.e., year +1 to year +3). This approach allows us to test our hypotheses regarding performance improvement following a CEO appointment.

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[5] Fahlenbrach *et al.* (2010) measure operating performance before the appointment as the average over event years -2 and -3 and after the CEO appointment as the average over event years +1 through +3. The change in operating performance as a result of CEO appointment is calculated as a difference between those two periods. Huson *et al.* (2004) measure the change in operating performance following the turnover as the difference between OROA from year -1 to year +3. The change in operating performance preceding the CEO succession is the difference between OROA from year -3 to year -1.

We obtain several interesting findings from this analysis. For the entire sample of appointments, the average OROA (i.e., mean and median) declines after the appointment. This result appears to be driven by the significantly large decline observed for CEO re-appointments. The average OROA appears not to change for CEO replacements. Although these findings are inconsistent with our second set of hypotheses regarding post-appointment performance, they support arguments present in the literature regarding the effects of managerial entrenchment and power. For instance, it is consistent with Erkens et al. (2015) who find that the reappointment of a CEO reduces the firm's operating performance.

In Panel B we undertake a similar analysis using the Huson et al. (2004) method for estimating the change in operating performance. Because the focus is on the average OROA for the pre and post appointment periods separately, we can test both sets of our hypotheses. During the pre-period (i.e., year -3 to year -1), we observe a significant decline in the average OROA for the entire sample as well as for the replacements and reappointments. The decline is an order of magnitude larger for the replacement group of appointments. This is as hypothesized. The decline in OROA for the reappointments is inconsistent with our hypothesis, but the decline is small in size and only marginally significant.

Our analysis for the post-appointment period offers only a hint of performance improvement. Over the years -1 to +3, OROA actually declines, but not significantly. The replacement CEOs enjoy a nominal increase in OROA, but the reappointed CEOs suffer a significant decline. Because of a lack of statistical significance for the difference between the replacement and reappointment groups, these results are only suggestive of differential post-appointment performance.

We draw several conclusions from these two sets of univariate analysis regarding the change in OROA and CEO appointments. There is mixed evidence regarding the nature of the firm's performance prior to a reappointment. It is not clear whether the firm's operating

performance justifies the CEO's reappointment. The findings reported in Table 6 do suggest that firms suffer a declining OROA prior to a CEO replacement. This is as we hypothesize and in consistent with the extensive agency and corporate governance literatures. Our results do not support a claim of improved operating performance following either a replacement or a reappointment, but weakly hint at such a relation.

These results are most interpretable in the context of the scapegoat hypothesis of Khanna and Poulsen (1994). The boards of directors replace top executives even if they are not responsible for the poor performance. In effect, the CEO turnover does not increase managerial quality and the newly appointed CEO does not necessarily enhance firm performance.

These results can also be partially understood in the context of a transitioning economy characterised by incomplete markets, a Socialist legal legacy, and no recent history of private enterprise. The current Polish Code of Commercial Companies was implemented only in 2001. The principles of corporate governance in the form of the Code of Best Practice were implemented on the Warsaw Stock Exchange only in 2002. Market participants and regulators are still learning the dynamics and behaviours of a market economy.[6]

5.3 Operating Performance Surrounding CEO Reappointments

We more thoroughly examine the relation between CEO appointments and operating performance with our multivariate analysis contained in Table 7. More specifically, we test Hypotheses H2a and H2b regarding post-appointment performance with the inclusion of the *Reappointment* variable. We observe that the coefficients of this variable are significantly negative in models (1) through (3). This implies that the reappointment of the incumbent CEO results in a subsequent deterioration of the firm's operating performance. These results hold for both industry adjusted and unadjusted measures of operating performance. Hence, these

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[6] Another potential explanatory factor, especially common in Central and Eastern Europe, is the political connections of persons managing and supervising firms. Jackowicz et al. (2014) using a data set covering the 2001–2011 period, find that political connections lower the profitability of non-financial firms in Poland.

findings are inconsistent with hypothesis 2b and suggest that the reappointment of our sample CEOs is not associated with the creation of shareholder wealth.

In models (4) through (6) we examine a shorter performance horizon. We find no statistically significant effect of *Reappointment* on changes in operating performance between years $t = -1$ and $t = +3$.

Across these same models, however, we observe a statistically significant negative relationship between changes in operating performance before and after the event. The bigger the change in operating performance before the board's decision is made, the smaller is the growth after the CEO's appointment, regardless of its nature.

We could argue that the CEOs' activities do not have much influence on the company's outcomes. The interaction variable (Models 4, 5, & 6; *Reappointment x Δ OROA –3 to -1)* shows, however, that in the case of CEO replacement the higher is the change in OROA prior to the appointment, the lower is the change in operating performance over the post appointment period. For re-appointments, greater changes in OROA prior to the event before the event are associated with a smaller post-event changes. The scale of this phenomenon is smaller, however, than for CEO replacements.

We also note some interesting relationships between our control variables and operating performance. We find that the firm's size as measured by sales exerts a consistently negative and significant effect on the firm's operating performance. We observe, however, that the firm's debt level (*Debt*) positively influences firm's operating performance. Higher levels of debt results in greater changes in OROA surrounding CEO appointments. The issuance of debt by a firm creates additional pressure on managers since the lenders act as monitors on the firm's activities. This is especially true in the case of bank debt who are highly effective monitors of a firm's continuing creditworthiness. They can challenge managerial decisions that reduce corporate free cash flow or otherwise threaten the firm's financial stability. These results are

consistent with Gilson (1990) who contends that lender monitoring can supplement or replace weak internal governance mechanisms.

6. The Likelihood of CEO Turnover

As a further test of the relation of corporate operating performance on the CEO appointment decision, we undertake a logit analysis of CEO turnover. In Table 8 we construct a dependent variable that is coded as one if the CEO is replaced and zero otherwise. We observe that the deterioration of a firm's operating performance before the event (Model 2, Δ *OROA -3 to -1*) significantly increases the likelihood of replacing a CEO. As further confirmation, we find in model (4) that *Industry-adjusted Δ OROA -3 to -1* is inversely related to the likelihood of CEO replacement. These findings are consistent with our hypotheses H1a and H1b regarding CEO replacements. That is, CEOs are replaced when operating performance declines. They are more likely to be reappointed when operating performance is strong.

We also obtain interesting results regarding CEO turnover that extend beyond operating performance. In models (1) and (3), we observe that if the previous CEO appointment was a replacement of top executive (*Turnover -1*), it is less likely that the next appointment will be a replacement. The previous CEO's term of office (*Tenure -1*) also has a statistically significant effect since the likelihood of appointing a new CEO decreases with the incumbent's term in office.

In models (2) and (4) we find that *Cumulative tenure -1* is also statistically significant. The longer the previous CEO is in office, the less likely it is that the CEO is replaced. Consistent with the results in models (1) and (3), we conclude from these findings that a CEO's long tenure in office reduces the likelihood of executive replacement. That is, CEOs can use the power they accumulate through long service to resist attempts at removal. These findings align with the literature on managerial entrenchment and its adverse effect on corporate governance.

7. Robustness Analysis

To assess the robustness of our results, we re-estimate our regression models that examine operating performance surrounding CEO appointments. We accomplish this by incorporating two additional dummy variables as regressors. These variables are: *Outsider* and *Forced Turnover*.

We motivate our inclusion of a dummy variable to capture the appointment of a corporate outsider as CEO based on Hambrick and Mason (1984). They argue that if a company wishes to transform itself or to respond to distressed circumstances, then it should appoint outsiders to senior management positions. Various studies provide evidence that investors expect an outsider CEO to create value for shareholder (Davidson *et al.*, 2002; Fahlenbrach *et al.*, 2010). To evaluate the effect of a successor's origins on operating performance, we include as regressors the variable *Outsider* and an interactive variable between *Turnover* and *Outside*r. Table 9 contains our results. We find no statistically significant effect of an outsider CEO on the firm's performance.

In Table 10 we introduce *Forced Turnover* and an interactive term between *Forced Turnover* and Δ *OROA –3 to -1* as new regressors. Their inclusion is motivated by the disciplining effect of a forced turnover. Forced turnover can be the result of poor performance but can also have a positive effect on subsequent performance as noted by Denis and Denis (1995) and Huson *et al.* (2004). We find no significant relation between forced turnover and the firm's subsequent operating performance. We conclude that our original findings remain valid even after including controls for the corporate origin of the CEO and the disciplining nature of the CEO's removal.

8. Discussion and Conclusion

In this study we examine the efficiency of internal governance in public companies traded in a post-Socialist country. We find that the decision to reappoint or to replace a CEO is preceded by a decline in the firm's operating performance. This decline is larger in firms where the CEO is replaced. This is consistent with our hypothesis regarding a decrease in corporate operating performance preceding the replacement of a CEO. We fail to find, however, significant improvements in operating performance following either the replacement or reappointment of the incumbent CEO. Our findings are consistent with managerial entrenchmet effects as well as the managerial power of Bebchuk and Fried (2003).

We obtain interesting findings regarding the likelihood of CEO turnover. The likelihood of CEO replacement is greater if the firm does not perform well in the period preceding the appointment decision. Although our sample of reappointments is generally preceded by weak financial performance as well, it does not appear sufficient to trigger their removal. Nor are reappointments followed by subsequent performance improvement.

Our study's findings are consistent with inefficiencies or inadequacies in the corporate governance system of Polish publicly traded firms. We conclude that future reforms in both the management and regulation of Polish public traded firms should focus on strengthening internal governance mechanisms and improving the procedures for selecting CEO candidates.

Appendix: Variable definitions

Variable	Definition
Board size	The number of persons in the Management Board at the time of the event.
CAR [0,+2]	Cumulative abnormal return in the 3 day window [0, +2] surrounding the CEO appointment.
Cumulative tenure	The current CEO's cumulative term of office in years including all continuous tenures calculated as the cumulative number of days divided by 365. If the current CEO is newly appointed *Cumulative tenure* equals *Tenure*.
Cumulative tenure -1	The previous CEO's cumulative term of office in years including all continuous tenures calculated as the cumulative number of days divided by 365. If the previous CEO was newly appointed *Cumulative tenure -1* equals *Tenure -1*.
Debt	Ratio of total debt to total assets at the end of the event year t=-1.
Excess return	Abnormal returns for shares over WIG return calculated for a six-month period before the event window.
Forced Turnover	The dependent variable equals 1 if the CEO is an outsider and 0 otherwise. The CEO turnover is classified as forced if the reason of CEO turnover was dismissal, resignation, retirement, the end of term of office or death/
Industry-adjusted Δ OROA -1 to +3	The dependent variable. A difference between industry-adjusted OROA in the post event year t=+3 and industry-adjusted OROA in the pre-event year t=-1.
Industry-adjusted Δ OROA -3 to -1	A difference between industry-adjusted OROA in the pre-event year t=-1 and industry-adjusted OROA in the pre-event year t=-3.
Industry-adjusted Δ OROA post to pre	The dependent variable. A difference between mean industry-adjusted OROA in the 3 years post event period [+1,+3] and mean industry-adjusted OROA in 3 year pre-event period [-3,-1].
Δ Ind OROA -1 to +3	A difference between mean industry OROA in the post event year t=+3 and mean industry OROA in the pre-event year t=-1.
Δ Ind OROA post to pre	A difference between mean industry OROA in the 3 years post event period [+1,+3] and mean industry OROA in 3 year pre-event period [-3,-1].
Δ OROA –3 to -1	A difference between firm's OROA in the pre event year t=-1 and firm's OROA in the pre-event year t=-3.
Outsider	The dependent variable equals 1 if the CEO is an outsider and 0 otherwise. An outsider CEO did not work in the company, but may have worked in a capital group, i.e., in an associated company
Previous CEO age	The age of previous CEO in the day of her/his appointment.
Reappointment	Re-appointment of the existing CEO for another term of office = 1 and otherwise = 0
Reappointment -1	If the previous CEO was reappointed for another term of office = 1 and otherwise = 0
Sales	Natural logarithm of sales from the event year t=-1.
Tenure	The current CEO's term of office in years (The number of days divided by 365)
Tenure -1	The previous CEO's term of office in years (The number of days divided by 365)
Turnover	The dependent variable equals 1 if the CEO is replaced and 0 if the CEO is reappointed.
Turnover -1	Equals 1 if the previous CEO was replaced and 0 otherwise.
Unadjusted Δ OROA –1 to +3	The dependent variable. A difference between firm's OROA in the post event year t=+3 and firm's OROA in the pre-event year t=-1.
Unadjusted Δ OROA post to pre	The dependent variable. A difference between mean firm's OROA in the 3 year post event period [+1,+3] and mean firm's OROA in 3 year pre-event period [-3,-1].

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Figure 1: Annual Distribution of the CEO replacements and reappointments
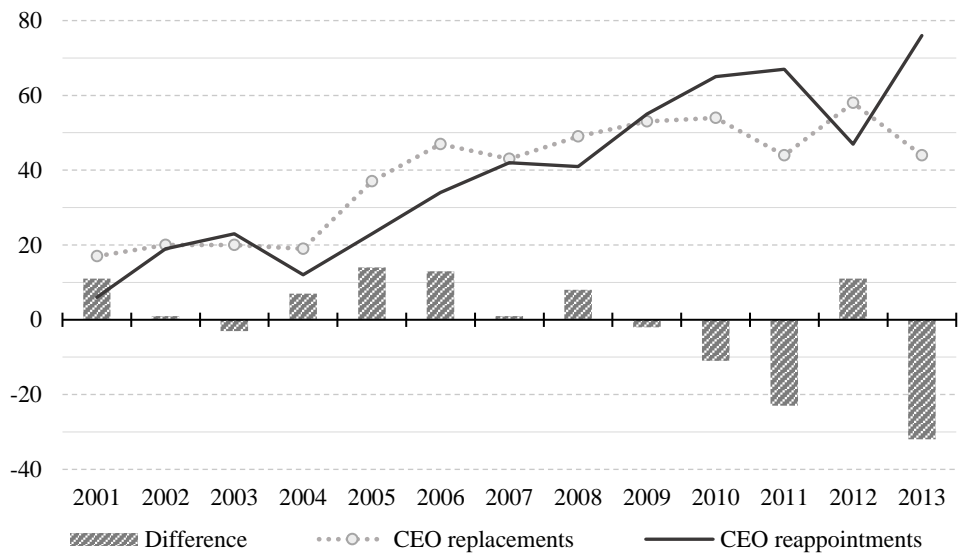
Table 1: Year and Industry Sample Distribution

	All CEO Appointments		CEO Replacements		CEO Reappointments	
	N	Percentage of Total CEO appointments	N	Percentage of Total CEO appointments	N	Percentage of Total CEO appointments
TOTAL Sample	1015	100,00%	505	49,75%	510	50,25%
Panel A: Annual Distribution						
2001	23	2.27%	17	1.67%	6	0.59%
2002	39	3.84%	20	1.97%	19	1.87%
2003	43	4.24%	20	1.97%	23	2.27%
2004	31	3.05%	19	1.87%	12	1.18%
2005	60	5.91%	37	3.65%	23	2.27%
2006	81	7.98%	47	4.63%	34	3.35%
2007	85	8.37%	43	4.24%	42	4.14%
2008	90	8.87%	49	4.83%	41	4.04%
2009	108	10.64%	53	5.22%	55	5.42%
2010	119	11.72%	54	5.32%	65	6.40%
2011	111	10.94%	44	4.33%	67	6.60%
2012	105	10.34%	58	5.71%	47	4.63%
2013	120	11.82%	44	4.33%	76	7.49%
Panel B: Distribution by Industry						
Finance	66	6.50%	39	3.84%	27	2.66%
Building	208	20.49%	92	9.06%	116	11.43%
Industry	421	41.48%	219	21.58%	202	19.90%
Services	196	19.31%	97	9.56%	99	9.75%
Trade	99	9.75%	45	4.43%	54	5.32%
Unidentified	25	2.46%	13	1.28%	12	1.18%

Table 2: CEO Descriptive Statistics

	All CEO Appointments		CEO Replacements		CEO Reappointments	
	N	Percentage of Total CEO appointments	N	Percentage of Total CEO appointments	N	Percentage of Total CEO appointments
Panel A: Distribution by CEO gender						
Male	971	95.67%	473	46.60%	498	49.06%
Female	44	4.33%	32	3.15%	12	1.18%
Panel B: Distribution by Insider/Outsider CEO						
Outsider	273	26.90%	273	26.90%	n/a	n/a
Insider	742	73.10%	232	22.86%	510	50.25%
Panel C: Distribution by experienced CEO in management						
Inexperience	81	7.98%	81	7.98%	n/a	n/a
Experienced	934	92.02%	424	41.77%	510	50.25%
Panel D: Distribution by experienced CEO in industry						
Inexperience	55	5.42%	54	5.32%	n/a	n/a
Experienced	960	94.58%	451	44.43%	510	50.25%
Panel E: Distribution by educational level						
General	793	78.13%	415	40.89%	378	37.24%
Elite	210	20.69%	90	8.87%	120	11.82%
Unidentified	12	1.18%	0	0.00%	12	1.18%
Panel F: CEO Age						
All CEO appointments	1004	24	46	46	73	
CEO replacements	498	24	45	44	73	
CEO reappointments	506	26	48	48	71	
Panel G: Tenure						
All CEO appointments	1015	0.00	2.26	2.17	10.51	
CEO replacements	505	0.00	1.87	1.46	10.51	
CEO re-appointments	510	0.00	2.65	2.95	8.77	
Panel H: Cumulative Tenure						
All CEO appointments	1015	0.00	3.36	2.90	16.01	
CEO replacements	505	0.00	1.88	1.46	10.51	
CEO re-appointments	510	0.02	4.82	4.13	16.01	

Table 3: Select Variable Descriptive Statistics

Variable	N	Min	Mean	Median	Max
Management Board size					
All CEO appointments	1010	1.00	2.87	3.00	9.00
CEO replacements	504	1.00	2.59	2.00	8.00
CEO re-appointments	506	1.00	3.14	3.00	9.00
Sales					
All CEO appointments	1002	2.64	12.00	11.95	18.24
CEO replacements	497	4.11	11.87	11.90	17.97
CEO reappointments	505	2.64	12.14	12.02	18.24
Debt					
All CEO appointments	987	0.0047	0.4819	0.4538	2.2180
CEO replacements	483	0.0047	0.5035	0.4752	2.2180
CEO reappointments	504	0.0285	0.4612	0.4423	1.8096

Table 4: Transition Matrix Between CEO States

		Total		New CEO *Outsider*		*Insider*	
		N	Percent of Total	N	Percent of Total	N	Percent of Total
Previous CEO	Insider	230	64.07%	127	55.22%	103	44.78%
	Outsider	129	35.93%	79	61.24%	50	38.76%
	Total	359	100.00%	206	57.38%	153	42.62%
CEO Turnover	Forced	186	36.83%	107	57.53%	79	42.47%
	Voluntary	319	63.17%	166	52.04%	153	47.96%
	Total	505	100.00%	273	54.06%	232	45.94%

Table 5: Announcement Period Analysis

Variable	N	Min	Mean	Median	Max
CAR (0, +2)					
All CEO appointments	991	-56.44%	-0.13%	-0.44%	44.82%
CEO replacements	495	-56.44%	-0.06%	-0.24%	44.82%
CEO reappointments	496	-15.75%	-0.10%	-0.54%	36.74%

Table 6: Changes in Operating Return on Assets (OROA) Surrounding CEO Appointments
The presented statistical significance of results is tested using the Wilcoxon signed-rank test. The difference between the means and medians of subsample - CEO replacement and CEO re-appointment is tested with the U Mann-Whitney two-sample test. Statistical significance at the one, five, and ten percent levels are indicated by ***, **, and *, respectively.

	All CEO appointments		CEO replacements		CEO re-appointments		Difference Replacement minus Re-appointment	
	Median	Mean	Median	Mean	Median	Mean	Median	Mean
Panel A: Fahlenbrach et al. with industry-adjusted OROA								
Sample	964	964	473	473	491	491		
Pre period [-3,-1]	-0.0581***	-0.0657***	-0.0749***	-0.0887***	-0.0488***	-0.0435***	-0.0261***	-0.0452***
Post period [+1,+3]	-0.0661***	-0.0743***	-0.0780***	-0.0897***	-0.0554***	-0.0593***	-0.0227***	-0.0304***
Δ OROA pre to post	**-0.0080****	**-0.0086****	**-0.0032**	**-0.0010**	**-0.0065****	**-0.0158****	**0.0034**	**0.0148***
Positive	*446*	*453*	*225*	*231*	*221*	*222*		
Negative	*518*	*511*	*248*	*242*	*270*	*269*		
Panel B: Huson et al. with industry-adjusted OROA								
Sample	964	964	473	473	491	491		
Pre year -3	-0.0547***	-0.0592***	-0.0647***	-0.0756***	-0.0497***	-0.0433***	-0.0150***	-0.0323***
Pre year -1	-0.0628***	-0.0761***	-0.0789***	-0.1054***	-0.0505***	-0.0479***	-0.0284***	-0.0575***
Post year +3	-0.0703***	-0.0817***	-0.0802***	-0.0974***	-0.0604***	-0.0666***	-0.0197***	-0.0308***
Δ OROA -3 to -1	**-0.0099****	**-0.0170****	**-0.0160****	**-0.0298****	**-0.0073**	**-0.0046**	**-0.0088***	**-0.0252***
Positive	*439*		*208*		*231*			
Negative	*525*		*265*		*260*			
Δ OROA -1 to +3	**-0.0023**	**-0.0056**	**0.0018**	**0.0080**	**-0.0069***	**-0.0187***	**0.0086**	**0.0267**
Positive	*475*		*237*		*238*			
Negative	*489*		*236*		*253*			

Table 7: Operating Performance Surrounding CEO Reappointments

Standard errors are shown in parentheses. Statistical significance at the one, five and ten percent levels are represented by ***, **, * respectively. Variables are defined in the Appendix.

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	Unadjusted Δ OROA post to pre	Unadjusted Δ OROA post to pre	Industry-adjusted Δ OROA post to pre	Unadjusted Δ OROA −1 to +3	Unadjusted Δ OROA −1 to +3	Industry-adjusted Δ OROA -1 to +3
Reappointment	-0.0124*	-0.0138*	-0.0188**	-0.0145	-0.0130	-0.0171
	(0.00753)	(0.00759)	(0.00850)	(0.0123)	(0.0124)	(0.0140)
Δ OROA −3 to -1				-0.592***	-0.600***	-0.594***
				(0.0905)	(0.0870)	(0.0831)
Reappointment x Δ OROA −3 to -1				0.260***	0.285***	0.242***
				(0.0933)	(0.0850)	(0.0900)
Cumulative tenure	0.00162	0.00188	0.00211	0.00191	0.00224	0.00374*
	(0.00186)	(0.00168)	(0.00178)	(0.00231)	(0.00223)	(0.00222)
Sales	-0.00696**	-0.00722**	-0.00662**	-0.00781**	-0.00804**	-0.00683*
	(0.00299)	(0.00303)	(0.00301)	(0.00329)	(0.00335)	(0.00348)
Debt	0.0480***	0.0406***	0.0349***	0.0694***	0.0686***	0.0512***
	(0.0150)	(0.0105)	(0.0110)	(0.0168)	(0.0153)	(0.0157)
CAR [0,+2]	0.0994**	0.0891*	0.123**	0.183***	0.183***	0.212***
	(0.0501)	(0.0485)	(0.0514)	(0.0540)	(0.0527)	(0.0695)
Excess return	0.0274***	0.0284***	0.0305***	0.0368**	0.0395**	0.0447***
	(0.00972)	(0.00980)	(0.0104)	(0.0163)	(0.0166)	(0.0172)
Δ Ind OROA post to pre		0.276**				
		(0.140)				
Δ Ind OROA -1 to +3					0.146	
					(0.119)	
Intercept	0.0220	-0.00254	0.0661*	0.0319	0.0143	-0.0892
	(0.0580)	(0.0451)	(0.0399)	(0.0594)	(0.0538)	(0.0610)
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
N	963	925	925	963	928	928
F	3.564	3.585	2.664	9.090	8.675	7.104
r2	0.185	0.201	0.210	0.344	0.353	0.313
r2_a	0.113	0.130	0.142	0.284	0.294	0.251

Table 8: Logit Regression of CEO Turnover

Standard errors are shown in parentheses. Statistical significance at the one, five, and ten percent levels are indicated by ***, **, and *, respectively. Variables are defined in the Appendix.

	Model 1 Turnover	Model 2 Turnover	Model 3 Turnover	Model 4 Turnover
Turnover -1	**-1.733*****		**-1.642*****	
	(0.464)		(0.473)	
Tenure -1	**-1.161*****		**-1.138*****	
	(0.187)		(0.190)	
Turnover -1 x Tenure -1	**0.860*****		**0.834*****	
	(0.209)		(0.211)	
Reappointed -1		0.0912		0.0603
		(0.316)		(0.322)
Cumulative tenure -1		**-0.300*****		**-0.302*****
		(0.0990)		(0.100)
Reappointed -1 x Cumulative tenure -1		0.0444		0.0406
		(0.117)		(0.119)
Δ OROA −3 to -1	-0.287	**-1.821*****		
	(0.881)	(0.682)		
Turnover -1 x Δ OROA −3 to -1	-1.577			
	(1.109)			
Reappointed -1 x Δ OROA −3 to -1		1.127		
		(1.147)		
Industry-adjusted Δ OROA -3 to -1			0.850	**-1.857*****
			(0.912)	(0.626)
Turnover -1 x Industry-adjusted Δ OROA -3 to -1			**-2.698****	
			(1.111)	
Reappointed -1 x Industry-adjusted Δ OROA -3 to -1				**2.279****
				(1.107)
Excess return	**-0.830*****	**-0.809*****	**-0.836*****	**-0.820*****
	(0.238)	(0.236)	(0.240)	(0.239)
Previous CEO age	**0.0254****	0.0118	**0.0260****	0.0120
	(0.0111)	(0.0103)	(0.0113)	(0.0105)
Board size	**-0.308*****	**-0.276*****	**-0.317*****	**-0.286*****
	(0.0718)	(0.0698)	(0.0718)	(0.0703)
Sales	-0.0782	-0.0510	-0.0636	-0.0396
	(0.0508)	(0.0493)	(0.0523)	(0.0508)
Debt	0.607	**0.574***	0.584	**0.583***
	(0.382)	(0.333)	(0.389)	(0.333)
Intercept	**3.577****	2.188	**3.268****	2.012
	(1.418)	(1.356)	(1.437)	(1.352)
N	668	668	644	644
r2_p	0.210	0.132	0.208	0.135
chi2	97.23	88.02	98.26	88.69
P	1.96e-11	7.44e-10	1.29e-11	5.71e-10

Table 9: Robustness Test: *Outsider* as a Regressor

Standard errors are shown in parentheses. Statistical significance at the one, five, and ten percent levels are indicated by ***, **, and *, respectively. Variables are defined in the Appendix.

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	Unadjusted Δ OROA post to pre	Unadjusted Δ OROA post to pre	Industry-adjusted Δ OROA post to pre	Unadjusted Δ OROA −1 to +3	Unadjusted Δ OROA −1 to +3	Industry-adjusted Δ OROA -1 to +3
Turnover	**0.0162**	**0.0197***	**0.0266****	0.0187	0.0170	0.0247
	(0.0105)	(0.0100)	(0.0112)	(0.0160)	(0.0163)	(0.0180)
Δ OROA −3 to -1				-0.333***	-0.316***	-0.354***
				(0.0750)	(0.0787)	(0.0946)
Turnover x Δ OROA −3 to -1				-0.261***	-0.285***	-0.242***
				(0.0933)	(0.0852)	(0.0905)
Outsider	0.0498	0.0457	0.0418	0.0410	0.0393	0.0502
	(0.0356)	(0.0369)	(0.0402)	(0.0422)	(0.0428)	(0.0473)
Turnover * Outsider	-0.0563	-0.0561	-0.0560	-0.0485	-0.0464	-0.0641
	(0.0378)	(0.0390)	(0.0428)	(0.0454)	(0.0463)	(0.0519)
Cumulative tenure	0.00165	0.00189	0.00208	0.00192	0.00227	**0.00374***
	(0.00185)	(0.00169)	(0.00179)	(0.00232)	(0.00224)	(0.00225)
Sales	**-0.00694****	**-0.00719****	**-0.00659****	**-0.00779****	**-0.00802****	**-0.00679***
	(0.00299)	(0.00304)	(0.00302)	(0.00329)	(0.00335)	(0.00348)
Debt	**0.0478*****	**0.0402*****	**0.0344*****	**0.0692*****	**0.0684*****	**0.0507*****
	(0.0151)	(0.0105)	(0.0111)	(0.0168)	(0.0152)	(0.0155)
CAR [0,+2]	**0.0992****	**0.0891***	**0.123****	**0.183*****	**0.183*****	**0.213*****
	(0.0500)	(0.0483)	(0.0512)	(0.0542)	(0.0529)	(0.0696)
Excess return	**0.0276*****	**0.0288*****	**0.0310*****	**0.0371****	**0.0398****	**0.0451*****
	(0.00978)	(0.00986)	(0.0104)	(0.0164)	(0.0167)	(0.0173)
Δ Ind OROA post to pre		**0.278****				
		(0.140)				
Δ Ind OROA -1 to +3					0.147	
					(0.120)	
Intercept	0.00953	**0.0846****	0.0473	0.0174	0.000868	**-0.107***
	(0.0610)	(0.0376)	(0.0413)	(0.0628)	(0.0566)	(0.0635)
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
N	963	925	925	963	928	928
F	3.276	3.330	2.451	8.305	7.957	6.554
r2	0.185	0.202	0.212	0.344	0.353	0.314
r2_a	0.111	0.130	0.141	0.283	0.292	0.250

Table 10: Robustness Tests *Forced Turnover* as a Regressor

Standard errors are shown in parentheses. Statistical significance at the one, five, and ten percent levels are indicated by ***, **, and *, respectively. Variables are defined in the Appendix.

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	Unadjusted Δ OROA post to pre	Unadjusted Δ OROA post to pre	Industry-adjusted Δ OROA post to pre	Unadjusted Δ OROA −1 to +3	Unadjusted Δ OROA −1 to +3	Industry-adjusted Δ OROA -1 to +3
Forced turnover	0.00895	-0.0000953	-0.00376	0.0115	0.00566	0.00860
	(0.0102)	(0.0106)	(0.0115)	(0.0149)	(0.0147)	(0.0161)
Δ OROA −3 to -1				**-0.441***	**-0.436***	**-0.466***
				(0.0668)	(0.0681)	(0.0743)
Forced turnover x Δ OROA −3 to -1				-0.230	-0.249	-0.171
				(0.181)	(0.165)	(0.125)
Cumulative tenure	0.000779	0.000604	0.000242	0.000453	0.000624	0.00195
	(0.00162)	(0.00156)	(0.00157)	(0.00208)	(0.00201)	(0.00198)
Sales	**-0.00703**	**-0.00738**	**-0.00686**	**-0.00821**	**-0.00855**	**-0.00725**
	(0.00298)	(0.00302)	(0.00299)	(0.00344)	(0.00351)	(0.00361)
Debt	**0.0490***	**0.0417***	**0.0363***	**0.0653***	**0.0639***	**0.0481***
	(0.0148)	(0.0104)	(0.0109)	(0.0152)	(0.0146)	(0.0151)
CAR [0,+2]	**0.0998**	**0.0898***	**0.125**	**0.210***	**0.212***	**0.234***
	(0.0506)	(0.0489)	(0.0520)	(0.0622)	(0.0620)	(0.0722)
Excess return	**0.0254***	**0.0260***	**0.0272***	**0.0297***	**0.0319**	**0.0372**
	(0.00975)	(0.00975)	(0.0103)	(0.0153)	(0.0156)	(0.0163)
Δ Ind OROA post to pre		**0.271***				
		(0.141)				
Δ Ind OROA -1 to +3					0.140	
					(0.104)	
Intercept	0.0171	**0.0988***	**0.0670***	0.0295	0.0165	-0.0897
	(0.0585)	(0.0364)	(0.0396)	(0.0597)	(0.0551)	(0.0614)
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
N	963	925	925	963	928	928
F	3.426	3.374	2.364	7.726	7.078	6.149
r2	0.184	0.199	0.207	0.339	0.346	0.306
r2_a	0.112	0.128	0.138	0.279	0.286	0.243