

THE REASONS OF CEO TURNOVERS: A NEW EVIDENCE FROM UK LISTED FIRMS**Pananda Pasaribu***

Program Studi Manajemen, Institut Bisnis dan Informatika Kwik Kian Gie,
 Jl. Yos Sudarso Kav. 87, Jakarta 14350

Abstract

The classification of CEO turnovers should be done properly in order to get robust empirical evidence on the studies of CEO turnover. Previous studies tend to rely only the official announcement of firms (CEOs) as the base of the classification. The study shows this approach may incorrectly classify CEO turnovers, particularly with pursue other interest reason, family reason, personal reason and health reason. Therefore, it is necessary to examine any news or recent report that are related to CEO turnover.

Keywords: Corporate Governance, CEO Turnover

Abstrak

Klasifikasi CEO *turnovers* harus dilakukan dengan benar untuk mendapatkan bukti empiris yang kuat mengenai studi tentang pergantian CEO. Studi sebelumnya cenderung hanya mengandalkan pengumuman resmi perusahaan (CEO) sebagai basis klasifikasi. Studi ini menunjukkan bahwa pendekatan ini mungkin salah mengklasifikasikan CEO *turnovers*, terutama dengan alasan lain, alasan keluarga, alasan pribadi dan alasan kesehatan. Oleh karena itu, perlu untuk memeriksa berita atau laporan terkini yang terkait dengan CEO *turnovers*

Kata Kunci : *Corporate Governance, CEO Turnover*

Pendahuluan

CEO turnover is deemed as an important firm event because it affects firm competitiveness and firm survival. There are two views on the decision of CEO turnover. *Firstly*, it can be viewed as a 'last resort' because other measures have failed to address certain issues within the firm (Goergen, 2012). *Secondly*, it is a proxy of good corporate governance practice such as board effectiveness (Dahya et al, 2002; Adams and Ferreira, 2009).

In the theoretical perspective, the decision of CEO turnover depends on the

board evaluation regarding firm performance and/or other signals that may indicate the quality of the CEOs. When the board evaluation is below a certain threshold, or equal to the expected quality of his or her replacement, the turnover decision will be taken (Jenter and Kanaan, 2008).

CEO turnovers can be divided into two parts, which are forced CEO turnovers and non-forced (routine) turnovers. Academics, who investigate CEO turnovers, predominantly rely on the reasons that are issued by firms or, sometimes, well-respected news outlets, namely the Wall Street Journal (Huson et al., 2001; Hillier et al., 2005; Hillier and McColgan, 2009). For instance,

* Alamat kini: Institut Bisnis dan Informatika Kwik Kian Gie, Jln Yos Sudarso Kav. 87 Sunter, Jakarta 14350
 Penulis untuk Korespondensi: Telp. (021) 65307062 Ext. 704. E-mail: pananda@kwikkiangie.ac.id

CEOs are categorised as retired when the firms formally announce it and their age reach a certain threshold. Or, CEO turnovers are categorised as planned succession when the firm said so or had been planned at least 6 months beforehand. In both cases, they are categorised as routine turnovers.

However, relying on one source in classifying CEO turnover may be prone to bias. It is correct when there is no bad news about the turnovers, particularly related to firm performance. But, it is wrong when there is bad news and, sometimes, firms may try to protect the reputation of the ousted-CEOs. This study will try to investigate whether such approach, by examining news before (or after) the turnover, in categorising turnovers effectively classifies forced and routine turnovers.

The results indicate that the studies that rely only on the official announcement from firms (and CEOs) tends to lead incorrect classifications. For instance, firms (CEOs) might say that the CEOs leave their position in order to pursue other interests, but this type of reason is not entirely the true reason. In some cases, this reason is still affected by poor firm performance.

This study will contribute several of ways to the literature on CEO turnovers. Firstly, this study will use different approach in categorising CEO turnovers. This study will examine all news that are related to CEO turnovers before and after the events such as analysts' comments, the latest information of firm performance (i.e. interim report of firm performance). Secondly, this study will use a large CEO turnover dataset for UK listed firms between 2005 and 2013. This dataset is bigger than previous UK-based CEO turnovers studies (Hillier et al., 2005; Dahya et al., 1998; Florou, 2005).

The remainder of this chapter is organized as follows. Section 2 provides research methodology on CEO turnovers.

Section 3 discusses the results and discussions. Finally, Section 4 provides the research conclusions and implication for future research.

Research Methodology

1. Sample Selection

This study will observe CEO turnovers for non-financial firms listed in the London Stock Exchange during the period 2005 to 2013. The firms must have CEO position. Similar to Hillier et al. (2005) and Florou (2005), this study classifies the top officer as the CEO. Since not all firms have a CEO title, the role of CEOs may be held by the managing director (MD). If the managing director does not exist, this study will use one of executive directors that have equivalent duties to CEO (e.g. COO or operating director).

2. The Classifications of CEO Turnover

CEO turnover is defined as a change in CEO identity. CEO turnover equals one if CEO turnover occurs in firm i and time t , and CEO turnover equals zero if else. CEO turnover will be divided into two categories: routine turnovers and forced turnovers.

Previous studies (Huson et al., 2001; Hillier et al., 2005; Hillier and McColgan, 2009) classified the CEO turnovers according to the report from the Wall Street Journal. They categorise as forced CEO turnovers when the CEOs are fired, depart due to dispute on a certain policy, or retiring before the age of 60. Furthermore, CEO retirement without a six-month notice is categorised as forced turnovers. On the other hand, CEO turnovers a result of death, poor health, and acceptance of other position within the firm or elsewhere, personal reason (or business reasons) that unrelated to business activities are categorised as routine (voluntary) CEO turnovers.

As the Bloomberg database provides the news around the CEO turnover event, the

classification of CEO turnover is based on that news. Any news that is related to profit warnings and performance decline around the announcement date will be classified as a forced turnover regardless of the official reason from the firms. For instance, the board of directors could publish the CEO turnover because of personal reasons, poor health reasons, or to pursue other interests. In fact, several analysts report profit warnings.

CEO retirement is the most frequent reason in CEO turnovers. This study will follow previous studies in defining a forced turnover with respect to CEO retirement. *Firstly*, retirement before 60 will be classified as forced-turnover. But, this study will not follow entirely on this approach because sometimes the CEO steps down before 60 even though the firm is performing well. *Secondly*, retirement that is followed by a profit warning will be classified as a forced turnover. *Thirdly*, it will be classified as a forced turnover if the CEO does not give a six-month notice. Besides retirement reasons, the CEOs can quit the firms to pursue other interests or personal reasons. This will be classified as a non-forced turnover if the CEO gives a six-month notice and there is no bad news about firm performance before the announcement. In addition, when the reason of the turnover cannot be found, it can be categorised through the successors. If the successor is an acting CEO, the turnover is categorised a forced turnover (Lau et al., 2009). CEO change due to CEO death is categorised as no turnover event (Kaplan and Minton, 2012).

In some cases, firm CEO could be stated as interim, acting, joint, and co-CEO. When interim or acting CEOs are removed, these events are deemed as no turnover events. This study only examines CEO turnovers which are on a permanent basis. Acceptance of a higher position in the same firm (e.g. becoming the board chairman) or elsewhere (e.g. as CEO) will be classified as routine turnovers.

3. Performance Measures and Research Tools

This study will use both the market and accounting data in measuring firm performance, which are stock returns and return on assets (ROA). The stock return is measured by a 12-month period return of stock a year prior the CEO turnover year. ROA is as defined net profit divided by book value of total assets. ROA is provided by the FAME database, while stock return are from the Bloomberg database.

As the study collects a large dataset from various sources, the study uses Microsoft Excel and SAS Enterprise Guide in order to do the data management (i.e. coding, merging). In addition, the study employs simple T-test for mean-difference to analyse forced turnovers and routine turnovers with respect to firm performance.

Research Findings

There are about 1527 CEO turnovers that can be identified. Table 1 indicates that the CEO turnover reasons and the average of firm performance indicators. Poor performance is the most common reason for CEO turnover events, while non-forced turnovers and retirement are the second and the third common reasons respectively. CEO turnovers that are caused by delisting reason will be excluded from the analysis since the reasons of the turnover cannot be properly provided from the Bloomberg database.

Table 1 shows that firm performance measures, namely ROA and stock return. CEO turnovers which are due to corporate action reason (i.e. right issue, loan extension) experience the worst performance with average firm performance of ROA and stock return are -0,34 and 53,32% respectively. These firms may not only experience poor performance but they also may experience financial distress.

Furthermore, all CEO turnover reasons, even for family, personal, and health reasons, are still related to firm performance as almost all ROA and stock return are negative. In the previous studies, family reason, personal reasons, and poor health are categorised as non-forced turnovers, but these three reasons have negative firm performance, for instance family reason, personal reasons, and poor health with ROA equals to -0.25, -0.13, and -0.18 respectively, and stock returns equals to -14.99%, -26.68%, and -11.43% respectively. The same figures also occur for CEOs who said they left their position to pursue other business opportunity or interest with ROA and stock returns equal to -0.27 and -45.25% respectively. This implies CEO turnovers for UK listed firms are likely influenced by firm performance regardless of the official announcements. Given these findings, this study tries to categorise CEO turnover in a slightly different way. Not only looking at firm official announcements, this study tries to assess news, analysts' comments on firm financial performance (i.e. interim or final results) around CEO turnover announcements. Fortunately, the Bloomberg database provides the sequence for that information.

Table 1. CEO turnover Reasons and Firm Performance between 2005 and 2013.

Delisted is CEO turnover as a result of firm decision to go delisting from the stock market. Non-forced turnovers refer to CEOs who are promoted to become the chairman, part of a planned succession, or CEOs who move elsewhere. Poor performance is CEOs who resign or are removed as a result of poor performance (experiencing loss or sales decline). Pursue other interests refers CEOs who resign a result of pursue other (new or personal) business interests (challenges). M&A is CEO turnover as a result of merger and acquisition activities. Corporate actions related to placing or right issue or disposal of unit business. Switching to other positions means CEOs who are moved to other position

in the boards except as the chairman. Family reason, personal reason, poor health means CEOs who resign by stating family reason, personal reason, and poor health respectively. Passed away means CEOs are deceased while still seating as the CEO. Retiring is when CEOs state that he or she is retiring in the public disclosure. ROA is measured net profit divided by total assets. Stock return is measured by a 12-month stock return at the end of the calendar year.

Table 2. New CEO Turnover Classifications and Firm Performance between 2005 and 2013.

Poor performance is CEOs who resign or are removed as a result of poor performance (e.g. experiencing loss or sales decline). M&A is CEO turnover as a result merger and acquisition activities. Passed away means CEOs are deceased while still seat as the CEO. Retiring is when CEOs state that he or she is retiring in the public disclosure. Becoming chairman is CEO who is promoted to become the chairman in the same firm. Move elsewhere is CEO who moves to other firm as CEO. Planned succession is CEO who resigns by giving six-month notice, no negative news, and usually less than 60 years old. Pursue other interests refers CEOs who resign as a result of pursue other (new or personal) business interests (challenges). Corporate actions are to related placing or right issue or disposal of unit business. Switching to other positions means CEOs who are moved to other position in the boards besides the chairman. Family reason, personal reason, and poor health mean CEOs who resign by stating family reason, personal reason, and poor health reasons respectively. Retiring reason, pursue other interest reason, family reason, personal reason, poor health reasons with forced classification refer to negative news or analysts' comments around the announcements. ROA is measured net profit divided book value of total assets. Stock return is measured by a 12-month stock return at the end of the calendar year. ***,

**, * indicates significance of t-test at the 1%, 5%, and 10% level respectively

Table 1.
CEO turnover Reasons and Firm Performance between 2005 and 2013.

| Code | Reasons | N | ROA | Stock Return (%) |
|------|-----------------------------|-----|-------|------------------|
| . | Delisted | 250 | -0.19 | -36.67 |
| 0 | Non-Forced Turnovers | 175 | -0.08 | -16.23 |
| 1 | Poor Performance | 513 | -0.33 | -40.75 |
| 2 | Pursue other interests | 117 | -0.27 | -45.25 |
| 3 | M&A | 52 | -0.26 | -13.63 |
| 4 | Corporate actions related | 40 | -0.34 | -53.32 |
| 5 | Switching to other position | 128 | -0.17 | -18.53 |
| 6 | Family reason | 13 | -0.25 | -14.99 |
| 7 | Personal reason | 34 | -0.13 | -26.68 |
| 8 | Poor health | 20 | -0.18 | -11.43 |
| 9 | Passed Away | 14 | -0.17 | -6.03 |
| 100 | Retiring | 171 | 0.07 | -1.40 |

Table 2.
New CEO Turnover Classifications and Firm Performance between 2005 and 2013.

| Reason | Code | Turnover Type | N | ROA | Stock Return (%) |
|-----------------------------|------|---------------|-----|----------|------------------|
| Poor Performance | 1 | Forced | 513 | -0.33 | -40.75 |
| M&A | 3 | Non_forced | 52 | -0.26 | -13.63 |
| Passed Away | 9 | Non_forced | 14 | -0.17 | -6.03 |
| Retiring | 10 | Non_forced | 122 | 0.11*** | 9.02*** |
| | 11 | Forced | 49 | -0.04*** | -28.38*** |
| Becoming Chairman | 13 | Non_forced | 83 | -0.17 | -17.74 |
| Move elsewhere | 14 | Non_forced | 49 | -0.07 | -29.12 |
| Planned Succession | 15 | Non_forced | 43 | 0.08 | 1.99 |
| Pursue other interests | 20 | Non_forced | 39 | 0.00*** | -11.26*** |
| | 21 | Forced | 78 | -0.40*** | -63.70*** |
| Corporate actions related | 41 | Forced | 40 | -0.34 | -53.32 |
| Switching to other position | 50 | Non_forced | 39 | 0.04*** | 2.25 |
| | 51 | Forced | 89 | -0.26*** | -28.00 |
| Family reason | 60 | Non_forced | 4 | 0.01** | -13.53 |
| | 61 | Forced | 9 | -0.36** | -15.73 |
| Personal reason | 70 | Non_forced | 8 | 0.10*** | 29.38** |
| | 71 | Forced | 26 | -0.21*** | -41.96** |
| Poor health | 80 | Non_forced | 9 | 0.00** | -3.67 |
| | 81 | Forced | 11 | -0.32** | -18.33 |

Table 2 reports almost half of CEO retirements are categorised as forced turnovers. This kind of turnovers tends to have lower ROA and stock returns with the routine ones. For instance the ROA and stock returns of forced turnovers for retired CEOs are -0.04 and -28.38% respectively. On the other hand, the ROA and stock returns of retired CEOs who are classified as routine turnovers are 0.11 and 9.02%. The t-test of mean difference indicates that the mean between forced turnovers and routine turnovers is statistically significant at the level of 1%. This result indicates that some CEOs may use retirements to cover up their poor results or older CEOs (more than 60s) are more likely to be removed from his or her position.

Similarly, it seems CEOs who left their position to pursue other interests is also the most common reason to quit CEO positions, but two-third of this reason is categorised as forced-turnovers with ROA and stock returns are -0.4 and -63.70% respectively. The t-test also indicates that the average of ROA and stock return of forced turnovers is statistically significant different from the routine turnovers at the level of 1%. One possible reason might be to protect former CEOs reputation (credibility) in the job market.

Moreover, Table 2 indicates the components of non-forced turnovers and their respective financial performance. Firms that conduct planned successions tend to have better performance (i.e. ROA equals to 0.08) than firms that promoting CEOs to become the chairman (i.e. ROA equals to -0.17). It can be deemed that the CEOs promotion might be related to a certain aspect (e.g. ownership) instead of CEO performance.

This classification also indicates that CEO turnovers as the consequences of family reason, personal reason, and poor health may be still related to firm performance. For example, CEOs who resign due to family reasons may not be true as some of them might be a result of poor performance. Table 2 shows that forced turnovers for family

reasons with ROA and stock returns equal to -0.36 and -15.73%. The average mean of ROA for forced turnover is statistically different from the mean of ROA for routine turnovers at the level of 5%.

Overall, Table 2 indicates that there are a significant difference in performance indicators for every reason and classification which suggests that firm official announcement on CEO turnover might not be entirely true and the turnovers are still subject to firm performance.

Research Conclusions and Implications for Future Research

CEO turnover has been widely studied as a proxy of effective governance. This means that CEO should be removed for their positions when firms suffer from poor financial performance. However, there is a tendency that previous studies may incorrectly classify CEO turnovers because it only relies on the official announcement of firms (CEOs).

This study has shown that some of the reasons of routine CEO turnovers are, in fact, affected from firm performance, namely retirement, pursue other interest, poor health, family reasons, and poor health. This study argues that firms may try to protect the former CEOs reputation (credibility) in the job market.

Overall, firm performance is still a predominant driver on the decision of CEO turnover. For the future of related studies, researchers should not rely on one source in classifying the turnovers. It is very important to classify CEO turnover correctly in order to obtain a robust empirical evidence on the study of CEO turnover.

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