

**SPEED OF CEO DISMISSAL:  
AN ATTRIBUTION-BASED MODEL OF WHEN BOARDS OF DIRECTORS  
FIRE CEOS IN RESPONSE TO PERFORMANCE DOWNTURN**

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## **ABSTRACT**

**YOUNG UN KIM: Speed of CEO Dismissal: An Attribution-Based Model of When Boards of Directors Fire CEOs in Response to Performance Downturn**  
(Under the direction of Dr. Hugh M. O'Neill)

This research examines the dynamics of the CEO retention and dismissal decision making process adopting an attribution theory perspective. Replacement of management is generally known as an essential element for firms experiencing performance downturn and in need of organizational turnaround. However, firms vary in their speed of CEO replacement as a response to performance downturn, and the relationship of speed to the efficacy of response has not been examined. This dissertation investigates three broad research questions. First, how does causal reasoning based on performance feedback explain the variance in CEO dismissal timing? Second, do boards misattribute the cause of performance downturn inappropriately to the CEO? If so, what are the post-succession performance consequences? Last, are firms dismissed faster due to increased level of legal scrutiny in the post Sarbanes-Oxley era?

While current debates about CEO dismissal have generally been dominated by economic and political perspectives on CEO/board relations, I argue in this paper that CEO dismissal may be driven by cognitive, behavioral, and symbolic reasons as well. I specifically examine how attributions of causality of different types of performance downturn affect the corporate boards' interpretations of CEO skill and their speed of response action. I predict that if board of directors view downturn as being internally caused and permanent, then the CEO will be dismissed faster. If boards view the downturn as

externally caused and temporary, then the boards will be less likely to dismiss the CEO or be late in their dismissal actions.

Based on a sample of 376 CEO dismissal observations in 348 public US companies during the period 1992-2009, I find that firms with a moderate speed in CEO dismissal outperform those that have faster or slower speeds of dismissal, showing that the response time after a downgrade can be an important variable affecting firm performance. The analyses also provided clear support for the relationship between different types of performance downturn and speed of CEO dismissal. Last, results also show that the time it takes to fire a CEO has increased over time (slower CEO dismissals), especially after the Sarbanes-Oxley legislation.

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## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background**

The decision to dismiss a CEO and select a successor is a rare, difficult, and important decision made by corporate boards of directors. The corporate governance scandals and Sarbanes-Oxley legislation has increased the vigilance of boards. As a consequence, CEOs of U.S. firms are being dismissed more frequently than ever before (Kaplan & Minton, 2006). Boards are likely to take action against any further damage, especially in underperforming firms (Boeker, 1992; Zhang, 2008). As such, CEO dismissal is seen as a typical response strategy for underperforming firms trying to initiate a turnaround (Castrogiovanni, Baliga, & Jr., 1992; Denis & Denis, 1995; Kesner, 1994; O'Neill, 1986a, 1986b). Yet, this action may not be the correct response to the problem.

While the assertion that CEO change is for the better has become generalized, empirical efforts to validate it are surprisingly sparse and have provided mixed results (Pitcher, Chreim, & Kisfalvi, 2000). Further, results find that CEO dismissals may not help firm performance in the long run or even in the short run (O'Neill, 1986b; Virany, Tushman, & Romanelli, 1992; Wiersema, 2002). Even after three decades of research, there is still a lack of consistent and robust findings in explaining antecedents and consequences of CEO turnover (Kesner, 1994; Pitcher et al., 2000; Finkelstein, Hambrick and Cannella 2008). Given such inconsistencies, Kesner (1994) argues that there are variables and relationships between variables that need further development and better articulation.

In light of such research gaps and lack of consistent and robust findings, I set forth a proposition that we must look at the dynamics of the CEO dismissal process (i.e. speed of CEO dismissal) and approach the process from perspectives other than the ones popularly used in prior research (i.e. attribution theory). This is in line with the call of CEO turnover related papers that are approached from a longitudinal and psychometric standpoint (Pitcher et al., 2000). Thus, this dissertation examines how causal reasoning of performance feedback affects the speed of CEO dismissal and ultimately post-succession performance.

## **1.2 Motivation for the Study**

This dissertation is motivated by lack of consistent results in explaining firm performance after a CEO is replaced (Finkelstein et al 2008). Because most prior research has focused on the static choice of the retention/dismissal decision, I posit that an important variable has been missed, which is the speed of CEO dismissal in response to performance downturn. The time it takes to respond to declining performance can be a significant variable in explaining post-succession performance. Dismissals which are too early or too late may have long-term negative consequences (Ertugrul & Krishnan, 2008).

Such heterogeneity in fast and slow responses to downturn can be explained by many theories. IO economists posit that industry characteristics and competitive positions affect how firms can and will respond to downturn (Caves, 1984; Chen, Smith, & Grimm, 1992; Porter, 1985). Behavioral theorists posit that cognitive and motivational orientations affect how decision makers frame, formulate and attribute causes which ultimately affect behavioral responses. Signaling theory posit that some firms may respond because of external pressures albeit may it be only a short-sighted and an incorrect resolution (Spence, 1974). Socio-political theories posit

that responses will be driven by power struggles and network structures (Cannella et al., 1993; Ocasio, 1999).

As board of directors are individuals with cognitive limitations and driven by incentives to meet shareholder needs, their decisions can be limited and short sighted (Fredrickson & Hambrick 1988; Westphal & Fredrickson 2001). Most of the theories used in examining CEO dismissals were based on economic and socio-political views, I approach it from a third perspective – attribution theory (Kelley, 1967; Weiner, 1974). Specifically, I examine how different types of performance feedback following performance downturn (measured as first analyst downgrade during a CEO's tenure) affects response speed by corporate boards. How a CEO responds to a downturn would be a significant signal in the CEO's managerial skills and the performance following the initial downturn would be a measure that corporate boards use to assess the CEO.

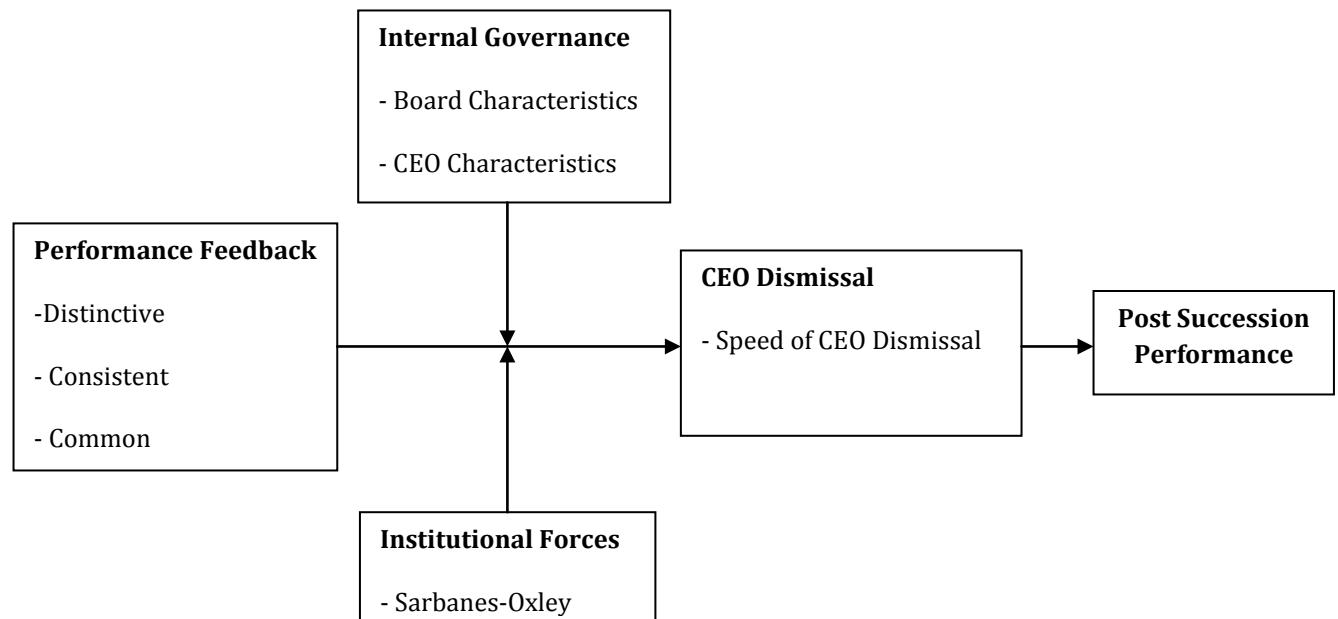
### **1.3 Research Questions Overview**

The research issue investigated in this study is how does performance feedback from firms incurring a downturn affect perceptions of the CEO skills and influence the ongoing choice of whether to fire or not. Three specific research questions are addressed to facilitate the investigation into this research issue. The three research questions are:

1. How does causal reasoning based on performance feedback explain the variance in the speed of CEO dismissal in response to performance downturn?
2. How does speed of CEO Dismissals in response to performance downturn affect post-succession firm performance?
3. Is the Sarbanes-Oxley act of 2002 affecting speed of CEO dismissals (i.e. faster)?

The theoretical framework employed in this research is based on the integration of causal reasoning based on performance feedback and agency theory. Figure 1 offers an overview of the general research model employed to explore these research questions. Although economic and socio-political aspects highly affect the CEO dismissal process (Finkelstein et al 2008), this research tries to contribute to the literature by thoroughly examining the cognitive aspects of corporate boards of directors.

Figure 1.1 The General Model



In order to address the above research questions, the study uses a research design employing both qualitative and quantitative data sources. To first analyze the antecedents of speed of CEO dismissal, I incorporate a hazard model analysis. Because my focus is on different responses in dismissal timing following a performance downturn, identifying the point of downturn is important. I use analyst forecast downgrade as the inception point of performance downturn. I measure the first dependent variable, speed of CEO dismissal, in terms of number of

months since first analyst downgrade of the CEO's tenure. For the latent variable 'post-succession performance' I examine accounting and stock based performance three years after CEO replacement. The analysis was conducted on a public sample of all firms over the years 1996-2009. The sample was narrowed down to include firms which have analysts following them and in which there was an analyst downgrade.

#### **1.4 Overview of the Dissertation**

This dissertation consists of five additional chapters. The literature review in Chapter Two includes an overview of the theoretical and empirical literature in the area of CEO Turnover. The review will start with a general overview of the CEO dismissal process and review factors that affect the decision to dismiss a CEO. I will then focus on cognitive aspects that affect the dismissal process and time it takes to respond. Chapter Three attempts to integrate the socio-political variables with the attribution variables I suspect will affect speed of CEO dismissal. I then develop hypotheses on why the speed of response is likely to affect future firm performance. Chapter Four describes the methodology, measurement and data used in this study. Chapter Five reports the results from the interviews. Chapter Six presents results from archival data analysis. Finally, Chapter Seven discusses the research findings and implications of this project.

## **CHAPTER TWO: THEORIES AND HYPOTHESES**

This dissertation examines the time it takes to respond to performance downturn by replacing the current CEO. First, an overview of the theoretical and empirical literature examining CEO dismissal is provided. I first give a general review of the CEO and why the CEO is important to the firm. Second, I review the corporate boards' role in monitoring the CEO. Specific attention is given to firms that are under performance distress. Next, a more fragmented literature examining behavioral and cognitive aspects is reviewed. This literature provides evidence that firms may vary in their speed of response to performance downturn. Finally, a framework on attribution theory is reviewed. This perspective provides a basis to understand the relationship between how corporate boards' causal reasoning of performance feedback affects the speed and timeliness in CEO replacement and ultimately future firm performance.

### **2.1 CEO Influence on Firm Performance**

A considerable body of research has examined the CEO. The effect of the CEO, CEO compensation, CEO entrenchment, effective CEO characteristics and CEO turnover are all popular topics that have been scrutinized (Bertrand & Schoar, 2003; Datta & Rajagopalan, 1998; Kesner, 1994; Murphy, 1999).

The CEO is responsible and accountable for an organizations strategy, design and performance (Kesner, 1994). However, empirical results examining how much the CEO really matters in firm performance has been mixed (Bertrand et al., 2003; Crossland & Hambrick, 2007; Haleblan & Finikelstein, 1993; Lieberman & O'Connor, 1972; Waldman, RamÃ-rez, House, & Puranam, 2001; Weiner & Mahoney, 1981). Results range from the CEO having very

little matter on performance to CEOs being a key determinant constituting more than half of the variance explained of firm performance. Lieberman & O'Conner (1972) found that CEOs matter far less to corporate performance than which company s/he runs or which industry s/he is in. Weiner (1981) and Wasserman (2001) also find the effect of the CEO to be small. However, these early studies were found to be statistically limited and were critiqued. Bertrand & Schoar (2003) captures the sole CEO effect apart from the firm effect by examining CEOs moving from one firm to another. They find that CEOs differ in management styles and thus approaches to company growth and financial aggressiveness differ. These findings support the upper echelon theory that managers with different background, experience and tenure incur different strategic initiatives (Hambrick & Mason 1984; Hambrick et al 1996). Subsequently, to resolve the mixed results, moderating effects at the CEO level, firm level and industry/macro level have been identified (Datta et al., 1998; Finkelstein & Boyd, 1998). As much of research supports the theory that CEOs can strategically change the firms discourse by reallocating strategic resources, acquiring or divesting business units, and infusing an organization with values and creating a culture which affects employee morale (Barnard, 1938; Schein, 1992; Selznick, 1957; Smith, Carson, & Alexander, 1984) it can be presumed that CEOs directly or indirectly affect performance. As such, the process of CEO dismissal and succession is likely to be as important as who the new CEO is. Also, as external parties view succession as a signal about the firm's future (Beatty & Zajac, 1987), the CEO succession is a defining event for every organization (Carey & Ogden, 2000).

## **2.2 The CEO Dismissal Process**

As the influence the CEO has on the firm is significant as mentioned above, the corporate boards' decision to replace a CEO will also have an impact on the firm. Research on CEO

turnover has been widely conducted for decades in various fields of business such as finance, accounting, human resource management, organizational behavior, and strategic management. This dissertation focuses on CEO dismissal, a specific type of CEO turnover.

### **2.2.1 Type of CEO Dismissal**

Dismissals are different from most CEO successions in which an incumbent steps down at an agreed-upon time, usually at the retirement age (Cannella et al., 2001; Friedman et al., 1989). Dismissals can be defined as involuntary turnover in which boards of directors are forced to oust the CEO, usually because of poor performance. Resignation, even though announced as voluntary, if due to board influence is usually classified as CEO dismissal (Finkelstein et al 2008).

CEO succession can also be classified as insider succession or outsider succession (Carlson 1996; Cannella et al., 2001). Inside succession is defined as the successor originating from inside the firm and outside succession is defined as the case when the successor is hired from outside the firm. Differences on how the type of succession affects strategic change and post-succession performance have been noted. Carlson (1961) found that insiders made fewer changes, were compensated less, and achieved less organizational status than outsiders. Post-succession performance results were mixed for insider and outside succession suggesting other contingencies may play a role. Antecedents to inside/outside succession have also been examined. Dalton & Kesner (Dalton et al., 1985) find that outside succession was more likely in the midrange of firm performers. Top performers or very low performers were less likely to choose outsiders. On the other hand Furtado and Karan (Furtado et al., 1990) found that outside succession was higher in underperforming firms. Karaveli (2007) using a continuous measure of ‘outsiderness’ find that the variable has no significant effect on post-succession performance.

To summarize, CEO turnover can be classified as voluntary/involuntary with inside/outside succession. This dissertation will focus on involuntary turnover, in other words CEO dismissal.

### **2.2.2 Role of the Board of Directors in CEO Dismissal**

Even though the CEO is so crucial to the organization, the CEO is an agent in which the firm has hired. Subsequently, the representatives of the shareholders, whom are boards of directors, can remove the CEO for many reasons. They can be displeased with firm performance and hold the CEO accountable for those results. Or, they may simply disagree with the direction the CEO is pursuing. Or, they may simply want to send a signal to investors that they are initiating a change (Carey et al., 2000). Whichever reason, the ability to dismiss a CEO is a strong governance mechanism which leads the CEO to act in the interest of shareholders (Eisenhardt, 1989; Fama & Jensen, 1983; Jensen & Meckling, 1976). There exists auditing committees which examines the performance of the CEO and sets appropriate compensations. In board meetings, boards have a chance to evaluate how the CEO is doing and decide whether to keep the current CEO and how much to compensate him/her with. Thus, the dismissal/retainment decision is an ongoing process with formal and informal evaluation methods.

The role of the corporate boards has ever so increased after the corporate corruptions were revealed in the early 2000's. The massive failures such as Enron, WorldCom, Tyco, and HealthSouth show that the boards of directors who are gatekeepers for not only the shareholders but all stakeholders such as the employees, customers, and the general public did not do their job (Kaiser 2005). The resulting meltdown in the financial markets led to a change in legislations and the enactment of the Public Company Accounting Reform and Investor Protection Act of 2002, which is commonly referred to as the Sarbanes-Oxley Act of 2002 (hereafter named SOX).

It is the most comprehensive federal securities legislation since the Securities and Exchange Commission (SEC) was created in the 1930s (Brown 2006). The law intended to impact the function of the board by mandating it be more independent and more accountable by providing more information to the public investors and also abiding by certain processes. As such, it is suspected that boards of directors become ever so more critical in corporate monitoring and their evaluation of CEOs.

### **2.2.3 Antecedents and Consequences of CEO Dismissal**

Of the many antecedents examined by scholars, prior firm performance and strong internal governance are two constructs that have been robust in explaining CEO dismissal. Weak firm performance is seen to increase CEO dismissal (Denis et al., 1995; Fredrickson, Hambrick, & Baumrin, 1988; Pitcher et al., 2000; Wiersema, 2002; Brookman & Thistle 2009). However reliance on different measures of prior performance lead to inconsistent findings and difference in percentage of variance explained. Also, presence of other factors tend to decouple or moderate prior performance on succession (Cannella et al., 1993; Finkelstein et al., 1998; Zajac et al., 1996). For example, Fredrickson (Fredrickson et al., 1988) conclude that board's expectation, attribution, allegiances, and values explain boards' action in replacing a CEO. Even though poor performance is evidently not tolerated by boards, the underlying process in how poor performance affects decisions of firing is not fully understood. The head of the organization could be fired as a "scapegoating" technique to signal to the shareholders and public that the board is trying to fix things (Gamson & Scotch, 1964), or it could be that boards truly believe the CEO is unskilled to lead the firm. Also, there is evidence that not all poor performance leads to CEO dismissal, but that relative firm performance is more important (Bushman 2008). External constituents such as the labor market, the market for corporate control, and proxy fights also

affect turnover (Jarrel 1980). Analyst recommendations and media coverage is also seen to increase CEO dismissal (Wiersema & Zhang, 2008). All of these causes are not mutually exclusive and these can act as moderating variables as well. Table 2.1 summarizes the causes of CEO dismissal. Many of these variables would also explain the speed in response time of CEO dismissals as well.

Table 2.1 Antecedents of CEO dismissal

Internal Variables	External Variables
<ul style="list-style-type: none"> <li>• Poor firm performance (Bankruptcy)</li> <li>• Internal governance (board of director size and characteristics)</li> <li>• CEO power (ownership, tenure &amp; experience)</li> <li>• Succession planning &amp; contestation</li> </ul>	<ul style="list-style-type: none"> <li>• Investing environment</li> <li>• Market for corporate control</li> <li>• Proxy fights</li> <li>• Managerial labor markets</li> <li>• Analyst coverage and recommendation</li> <li>• Media coverage</li> </ul>

The consequences of CEO dismissals have been examined largely in three types: 1) accounting performance consequences, 2) stock market response, 3) level of strategic change. Most studies examining post-succession consequences examine accounting performance two or three years after succession (Finkelstein & D'Aveni, 1994; Virany et al., 1992). Evidence indicates that succession can have a positive effect on performance (Helmich & Brown, 1972) and a negative effect (Tushman & Rosenkopf, 1996), or be inconsequential because it may often be a symbolic scapegoating event (Boeker, 1992; Brown, Foster, & Noreen, 1985; Gamson et al., 1964). Inconsistencies in the findings have been attributed both to methodological problems and failure to investigate important variables or contingencies (Kesner, 1994). Finkelstein and

Hambrick (1996) claim that conditions surrounding the succession, the choice of the successor and characteristics of incumbent and successor and measurement of performance should be better acknowledged. Stock market responses to CEO dismissal have also indicated positive effects and negative effects. Beatty & Zajac (1987) find a negative response for change in CEO announcement. Others find that the market reacts heterogeneously by prior firm performance, CEO tenure, successor choice(Beatty et al., 1987; Friedman et al., 1989; Shen & Jr., 2003). Post-succession strategic and structural change has received less attention. CEO change is frequently associated with high levels of strategic change (Carroll, 1984; Greiner & Bhambri, 1989). Virany, Tushman, & Romanelli (1992) find that the positive impact of succession is positively moderated by level of strategic reorientation and staff changes. Even with growing literature on the consequences of CEO change, post succession consequences are still underdeveloped and empirical results are inconsistent (Kesner, 1994; Pitcher 2000). Also, there should be more work acknowledging that CEO change may have disruptive effects on organizations (Beatty et al., 1987; Carroll, 1984)

#### **2.2.4 Disruptive Effects of CEO dismissal**

Many argue that the surest route to business improvement involves CEO replacement, yet little guidance is available in deciding when CEOs should be replaced and who should succeed them (Castrogiovanni et al., 1992). The costs associated with a CEO replacement are quite high and should be considered when boards make the decision to fire.

CEO dismissal can occur as an adaptive response to changing environmental conditions or when the CEO is not a good fit for the firm. Replacing the CEO if unskilled and is the cause of downturn would most surely be the correct choice. From a resource dependence perspective (Pfeffer & Salancick, 1978), shifts in who holds power at the firm is seen as adaptive shifts. The

adaptive view would predict that most CEO successions would result in positive post-succession performance as the firm changes in a response to make a better fit. This view assumes that the dismissal process is rational and that the successor is appropriate for the role.

However, boards are bounded in their cognitive capabilities and biases may lead to misattributions. They are also motivated by obligation to shareholder interests, personal incentives and network ties. Such forces may lead to inappropriately dismissing the CEO. When corporate performance falters, boards frequently misdiagnose the problems, fire incumbents, and search for charismatic successors—often with disappointing results (Khurana, 2002). There are also strong forces leading to wrong selection of the successor. Internal pressures toward homogenization may result in considering only a subset of alternatives. Dalton & Kesner (1992) note that the likelihood of outside succession is low because powerful internal constituencies may resist change. Frequently succession is seen as admitting failure (Dyl, 1985), and outsiders may also be reluctant to take a job in which firm performance is in downturn (D'Aveni, 1989). For example, when Kodak faltered in the early 1990s, its directors fired CEO Kay Whitmore and, amid great fanfare, appointed then-Motorola president George Fisher. But Kodak's problems stemmed from difficulties adapting to new technology—not ineffective leadership. Kurana 2002 says that the diagnosis of the performance downturn was wrong and the “savior” proved impotent, and Kodak remains a “horse-and-buggy” operation in a digital-photography world. Boards incur the same traps in diagnosing organizational failure as managers do.

As there exists costs that can lead to detrimental effects for the firm, boards should diligently consider all costs including behavioral and cognitive pitfalls that might lead to ineffective firing decisions. Costs of CEO dismissal can be categorized into five types: 1) financial costs 2) disruption costs 3) misdiagnosis costs 4) succession fit costs 5) timing costs.

There exist financial costs of changing including severance pay to the former CEO and costs of finding a replacement. These costs may range up to several million dollars. Also, CEO change is highly disruptive (Virany et al., 1992) as the new CEO needs to adjust to his or her role and especially when employees resist change. In some cases because there is so much resistance, strategic reorientation with no CEO change resulted in better increased performance (Virany et al., 1992). Because boards do not participate in everyday activities, they are prone to misdiagnosing the source of downturn. Boards rely on filtered data and salient information and are prone to selective perception (Barker, 2005). Boards may also tend to develop self-serving causal interpretations and misattributions related to distinctiveness, consistency and commonality of the performance downturn. Such misdiagnoses will affect who to replace as the successor and also the timeliness in response to downturn. Many boards fire the CEO under poor firm performance. However, Khurana (2002) proposes that crises are often the worst times to seek saviors. Carroll (1984) finds that rates of organizational death increase following succession. Grusky (1963) further suggest that low organizational effectiveness leads to succession that disrupts an organization and further reduces its effectiveness leading to a vicious downward circle. Also because leader intentions and organizational outcomes are generally loose, succession may lead to insignificant or unpredictable changes in performance. Dismissal can be an action signaling the board is fulfilling its obligation to the interests of shareholders. Gamson and Scotch (1964) find a “ritual scapegoating” among succession events in sports teams. The performance consequences were nonexistent. However, as there are financial and disruptive costs to CEO dismissal, even scapegoating events would lead to some amount of performance downturn. Boards may use CEO change as a panacea instead of correctly diagnosing the problem and finding the appropriate solution while considering other actions. Subsequently, weighing the

costs and benefits is crucial to making an optimal decision in whether to dismiss, when to dismiss, and who to select as the replacement.

### **2.3 Speed of CEO Dismissal**

Even though speed of response to performance downturn can be an important variable in explaining post-succession performance, little research has been conducted on the timing of the decision to dismiss a CEO. Timing is an important variable in strategy research. Studies of organizational change suggest that adjustments to fit the environment need to be made in a timely manner but because of various cognitive, economic and socio-political constraints it is difficult to do so (Barr & Huff 1997; Nadkarni & Barr 2008). Barr & Huff (1997) point out different beliefs about cause and effect is a plausible explanation for differential timing of responses to environmental change. Dranikoff, Koller & Schneider (2002) studying divestitures also find that firms are late in their response due to inability to detect and also failure to admit their faults in strategic planning.

Just as strategic change and divestiture responses vary in their timing, the decision to dismiss the CEO in a timely manner may vary as well. Anecdotal evidence has shown that some firms are faster in dismissing their CEO, whereas others fail to change the CEO even with long durations of underperformance (Golden & Zajac, 2001). For example, Qwest Communications CEO Joseph Nacchio resigned at the board's request in June 2002. Qwest stock price had fallen more than 92 percent compared to July 2000. Analysts called this case of CEO dismissal too little and too late. Another example is that of PSINet, where CEO William Schrader resigned in May 2001 after rumors in the media that the company might file for bankruptcy. According to a vice president of research at Robert W. Baird & Co., "Schrader's departure comes at least a year too late and he is the main culprit for the company's fall". On the other hand, some CEOs are

fired very early, even without significant performance downturn. Douglas Ivester stepped down as CEO of Coca-Cola after serving only two years. *Wall Street Journal* posed the question “So fast?” (McKay & Deogun, 1999). Another example is Joe Briner, CEO of Alpha Bank & Trust. He had reported large increases and growth during his two years of tenure but was fired soon after the first quarter of loss reported.<sup>1</sup> Inter-Lakes Health CEO Roger Masse was dismissed only after five months on the job.

The examples show there is wide variance in speed of CEO dismissals. Especially, how responsive they are to performance downturn and the actions taken are sure to affect a firm's performance. However, few scholars have acknowledged the importance in such timeliness and responsiveness to downturn in CEO dismissal. Thus, examining antecedents and consequences of early or late dismissal is novel and important. Early dismissals can protect the firm from further damage by an incompetent CEO and signal that the firm is pursuing a change. Allowing low quality CEOs to stay in position may not leave enough room for action to revitalize a firm as downturn triggers a downward spiral with internal and external constituents withdrawing support from the firm (Cameron, Whetten, & Kim, 1987; D'Aveni, 1989; Hambrick & D'Aveni, 1988, 1992). However, too early a dismissal may cause unnecessary disruption and incur real costs when not needed. Also, it takes time for a CEO to develop competence and corporate boards should give sufficient time in order to accurately assess CEO skills. Sometimes change occurs without due regard with the need for change. Lucius Cary (1641)<sup>2</sup> noted that “When it is not necessary to change, it is necessary not to change”. This passage emphasizes that there are costs associated with change and thus fixing a non-existing problem will be expensive. Examples of

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<sup>1</sup> Examples of Late Dismissals came from Ertugrul, M. & Krishnan, K. 2008. Can CEO Dismissals Be Proactive? SSRN eLibrary.

<sup>2</sup> Lucius Cary, a British statesman spoke this in Parliament, 1641. It is said to be repeated by J. F. Kennedy (1917-1963).

such real costs are compensating a CEO for early retirement and disruptions in culture and motivation of the company. Boards may be too hastened and may not utilize a decision-making criterion with full information. However, prior literature has mainly focused on CEO entrenchment and inert boards viewing most CEO dismissals as being too late. Scholars examining firms' competitive action and response tendencies find that quick responders gain market share over the expense of slow responders (Chen et al., 1992). However, especially with boards being held more and more liable for organization failures, CEOs may be dismissed too early. Or they may be blamed unjustly for poor performance. As Useem (2003) points out "Good decisions premised on strategic thinking and followed by timely execution will give the board what it needs to give the investors what they deserve". Subsequently, the speed of CEO dismissal decisions is an important construct to be fully examined.

## **2.4 Cognitive Perspectives in CEO Dismissal**

Recently, we have seen the exercise of board power increase (Economist, 2004). Boards are exercising their latent power to make or approve critical decisions and to be more active in their governance of the corporation (Chatterjee et al 2003). However, boards still appear to vary in their effectiveness in assessing performance problems and making appropriate managerial changes (Useem, 2003; Westphal & Fredrickson, 2001). The majority of the literature portrays the boards of directors as rational, and CEO entrenchment has been the focal explanation of not dismissing the CEO in a timely manner (Boeker, 1992; Boeker & Goodstein, 1993; Cannella et al., 1993; Cannella & Shen, 2001; Zajac & Westphal, 1996).

As boards of directors are comprised of individual humans they are prone to cognitive limitations, perceptions and biases. Most directors face competing demands for their time and keep carefully budgeted schedules (Lorsch & MacIver, 1989; Mace & Myles, 1986). They fail to

do necessary homework for understanding company problems (Lorsch 1986: 107). Individual level and group level cognition affect decision making. Cognitive conflicts can arise in groups that face interdependent and complex decision-making tasks (Forbes & Milliken, 1999). In such cases boards are liable to characterize issues differently and hold different opinions about what the appropriate responses to issues are (Dutton & Jackson, 1987). An opposite dysfunctional group decision making process is one of group think (Mullen & Anthony, 1994). It occurs when boards reach consensus without critically testing and analyzing full information, especially ones that contradict the majority opinion.

Board composition and demography have been used to predict the behavioral motives behind CEO dismissal. Outsider-dominated boards are more likely than inside-dominated boards to dismiss a CEO (Boeker, 1992; Cannella et al., 1993; Weisbach, 1988). However, board composition does not directly reflect the actual behavior of boards and we should look more at the processes and mechanisms which link board decisions with performance (Pettigrew, 1992). Board composition has been used mainly from a socio-political approach. Thus, an assessment of the boards' 'sense-making' of performance and then its 'interpretation' of performance is needed (Ford, 1985; Ford & Baucus, 1987; Halebian & Rajagopalan, 2006). Halebian & Rajagopalan (2006) posit that board sense-making and interpretation have only rarely been explored, and the full range of the cognitions that likely impact dismissal decisions have not been elaborated. Fredrickson (1988) and Ford (1986) also posit that variance in CEO dismissal decisions can be explained by examining the role of various board cognitions.

Even though board composition and demography have been used as proxies that affect cognition, attribution patterns may be less influenced by governance structure than the actual type of performance that affects boards' perception. Performance is a major indicator of CEO

efficacy and if performance is weak boards make interpretations about the problem and attributions to the cause of the problem. There is much empirical support in that CEOs are fired when an organization performs poorly (Furtado et al., 1990; Kesner, 1994; Salancik & Pfeffer, 1980). However, prior firm performance explained a very low percentage of the variance (Fredrickson & Hambrick 1988, Finkelstien & Hambrick 1996) and different measures of prior low firm performance has lead to conflicting results (Pitcher et al., 2000).

In this study, I focus on performance feedback as a mechanism which triggers corporate boards to find a solution. Performance feedback is a major indicator of how the CEO is doing. Puffer & Weintrop (1991) posit that inconsistent findings in how firm performance related to CEO turnover is due to insufficient attention of the type of performance indicator used by boards making the CEO turnover decision. Stock price performance, accounting ratios and financial analyst earnings targets were tested to see how board's decision to dismiss a CEO varies. On a similar vein, the level of attention may vary based on the informational characteristics of performance of being distinctive, consistent and common. My dissertation looks not only at differences in stock or accounting based performance measures but of qualitative differences in information the performance indicator provides. Information following a downturn will be very informative of the CEO skills. Such performance indicators will give different feedback information which affects the noticing, interpreting, and attribution of the performance. Research on performance feedback has mostly been examined from a behavioral perspective in which performance history affects ones aspiration level and based on that the behavior to the response will differ. Prior firm performance was seen as a point of reference used to notice a problem. However, I posit that different types of performance information will lead to different attributions of causality and temporality which will cause different responses (dismissal

decisions). Different types of performance information give different informational cues. The distinctiveness, consistency, commonality of prior firm performance give different informational cues and different perceptions of the information give different interpretations (Kelley 1967, 1972, 1973, Weiner 1974). However, it is not yet known if consistent underperformance is the reason or if sudden downturn triggers CEO dismissal. Is it low performance relative to competitors or is it absolute low performance regardless of industry performance? Depending on the salience, frequency, and commonality of the information noticing, interpreting and responding to such information will differ. Thus, in some cases boards are prone to misattribution. It is because salient, frequent and uncommon performance feedback will lead to bias for internal causes. If so, boards of directors may be prone to an attribution error in which CEO dismissal actions may not necessarily be the correct action.

In addition, while there has been considerable progress in trying to incorporate cognitive perspectives into the CEO dismissal research, most of the research has been conceptual. Sebor & Kesner (1996) posit that boards of directors are bounded rationally and the CEO dismissal and successor selection processes are characterized by three components: aspiration, judgment and justification. Haleblian & Rajagopalan (2006) develop a three stage CEO dismissal framework. They look at how aspirations and board composition lead to different perceptions and interpretation of performance. Though Haleblian and Rajaopalan (2006) lay out “attributions for performance” as a major step in interpretation to decide whether to take action to dismiss or not, their paper differs from my dissertation in several aspects. First, it is a conceptual paper with no empirical evidence. They do mention briefly but do not go into depth in theorizing each of the constructs of distinctiveness, consistency and commonality and how they will affect dismissal decisions. How performance information constructs will interact with agency constructs and

institutional forces is not examined. Third, the dependent variable examined is different from this study. They do not examine how performance information characteristics will affect timing of dismissal and successor choice but focus on the static decision. Last, they do not theorize on how cognitive dimensions will affect post-succession performance.

### **2.3.1 Attribution Theory**

Attribution theory has a long history in social psychology and has started to be more frequently used in the business domain to explain organizational behavior. Attribution theorists are concerned with the perceived causes of events and the consequences of the particular types of perceptions involved. The theory explains the process through which individuals assign causes for particular behavior or outcomes (Jaspars, Fincham, & Hewstone, 1983; Kelley, 1967; Kelley, 1972; Kelley, 1973; Weiner, 1974). Most outcomes are some type of performance feedback and depending on such feedback, individuals will reason the causation of such performance and respond with an action.

More work has been done in the micro organizational behavior (OB) and human resource (HR) area which use attribution theory. Barry Staw (1983) introduced that organizational participants use performance as a cue by which they attribute characteristics to themselves, their work groups and organizations. Most OB and HR scholars have looked at how managers perceive and explain the poor performance of subordinates (Mitchell, Green, & Wood, 1981) and how such attributions affect their behavior.

In strategy literature, causal reasoning has been used to explain firm performance. Using an analysis of corporate annual reports, Bettman & Weitz (Bettman & Weitz, 1983) found self-serving patterns of attributions in public firms. Unfavorable outcomes were attributed more to external, unstable, and uncontrollable causes than were favorable outcomes. Salancick and

Meindl (1984) find that managers strategically manipulate causal attributions to manage impressions of their control. Most have looked at the relationship between these attributions and future company performance. Ford (1985) proposed a model in which performance downturn characteristics, decision makers characteristics and organizational characteristics affect dimensions of attribution which lead to different response strategies. In this dissertation, I apply that model to the CEO dismissal phenomena and empirically test it.

Thus, in this dissertation I focus on the different characteristics of performance to see if CEO dismissal decisions and successor choice decisions are affected by such criteria. My work draws heavily from Ford's (which borrows from Kelley's attribution model) attribution model but extends the model to the domain of CEO dismissal. I question whether boards are prone to systematic bias in the information they are evaluating. The central thesis of the current study is that depending on the informational characteristics of the outcome, which equal performance, this will affect the board's perception and motivation to fire a CEO. If boards are prone to systematic bias based on informational performance characteristics they use as a metric for CEO evaluation which affects post-succession performance, there could be several normative implications for CEO dismissal decision-making.

### **CHAPTER THREE: THEORY DEVELOPMENT AND HYPOTHESES**

Chapter one provided an overview of the research issue and the general model, and offered three specific research questions.

1. How does causal reasoning based on performance feedback explain the variance in the speed of CEO dismissal in response to performance downturn?
2. How does speed of CEO Dismissals in response to performance downturn affect post-succession firm performance?
3. Is the Sarbanes-Oxley act of 2002 affecting speed of CEO dismissals (i.e. faster)?

Chapter two reviewed literature examining the CEO dismissal process. This literature helps establish the domain of interest (i.e. speed of CEO dismissal) of this dissertation. Chapter two also reviewed the disruptive effects of CEO dismissal and how board cognition may affect sub-optimal response time to performance downturn.

In this chapter I relate attribution theory to the speed of CEO dismissal and develop hypotheses on how different types of performance feedback following performance downturn affects speed of dismissal and also examine post-succession performance implications.

Furthermore, I hypothesize on how the Sarbanes Oxley also affects the speed of dismissal and firm performance.

#### **3.1 Effects of Different Types of Performance Feedback on Speed of CEO Dismissal**

Boards of directions, as being humans, have a limited ability to process information and their decision making also depends on their motivations (Fisman, Khurana, & Rhodes-Kropf,

2005; Puffer & Weintrop, 1991). Subsequently, attributions of cause of performance downturn are also biased due to cognitive limitations and incentive based motivations (Shen and Cannella 2002). As such, attribution processes can be linked to schema-driven processes and motivational and incentive based processes (Miner, 2005). The first type of attribution process arises because boards have limitations in processing information (i.e. performance feedback). They will be selective in attending to information and will reduce the complexity of information to find a satisficing solution (Cyert, 1963). Thus, they will most likely be biased to attend to more salient and consistent feedback information. They will also be comfortable with information relevant to their existing mental schema (Prahalad & Bettis 1986; Gary & Wood 2011). The second type of attribution process can be seen as being motivated to justify performance downturn based on personal benefits (Boeker, 1992; Staw et al., 1983). If there are pressures for a need to blame the cause of downturn or signal that action is being taken to resolve the issue, this type of attribution process will arise. For example, boards will be prone to take action, such as scapegoating the CEO, if performance downturn is distinctive leading to dissatisfied shareholders. As such, justification is not only an internal process in which outcomes are rationalized to oneself but is a process that is externally directed (Staw, 1980) as described in the impression –management literature (see Schlenker 1980) for a review. Thus, the two attributional processes can be viewed as complementary and similar antecedents explain these processes. Understanding how this motivational perceptual process operates is the domain of attribution theory. And, I use this attribution theory to explain the speed of CEO dismissal and post-succession consequences.

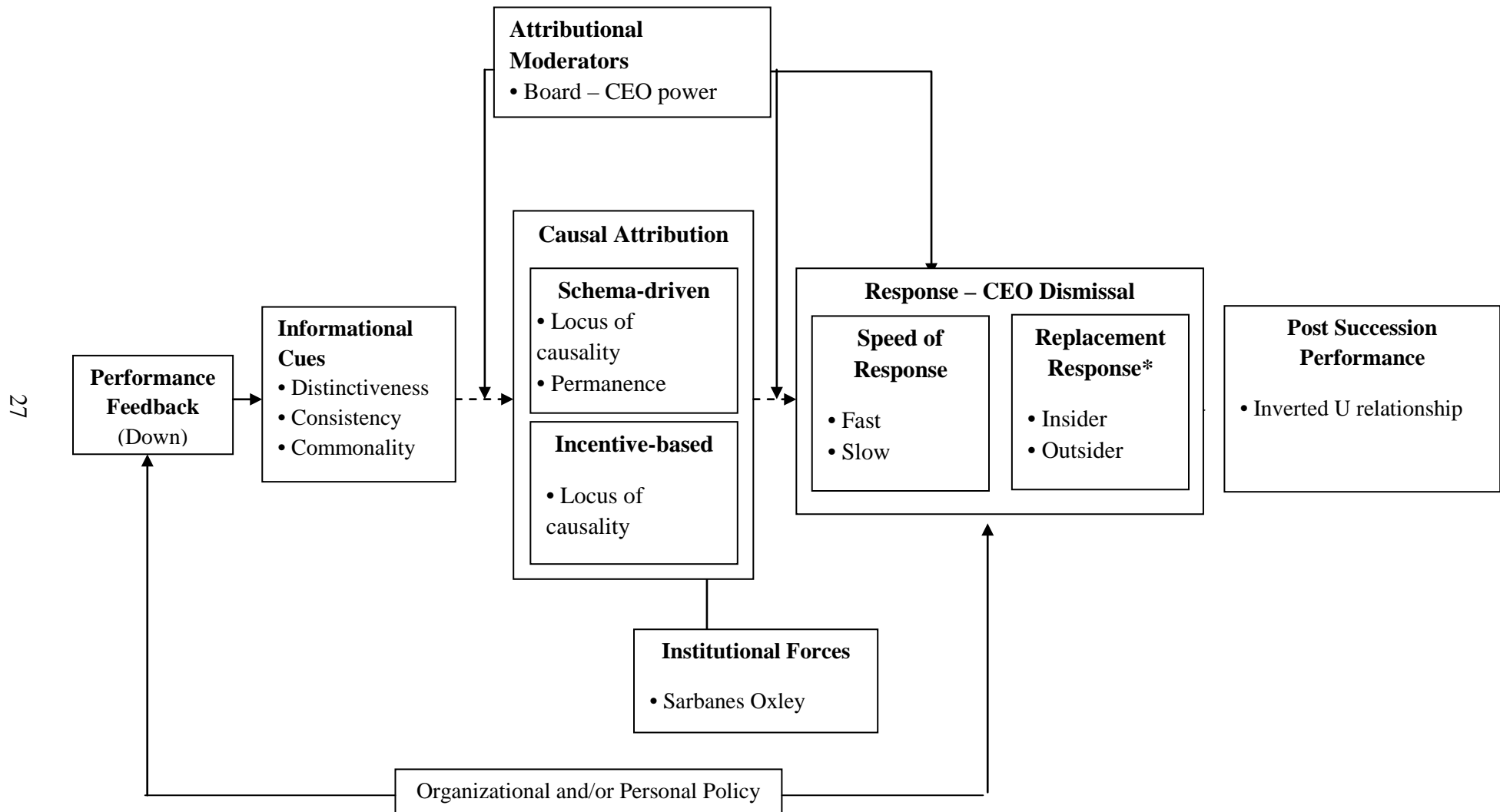
Attribution theorists posit that humans are prone to systematic biases in attribution. The most typical bias is in the form of actor/observer differences: people involved in an action (actors) and responsible for such actions view things differently from people not involved

(observers) and not responsible. The fundamental attribution bias is the tendency to overestimate dispositional explanations while underestimating situational causes for others behavior (Ross, Amabile, & Steinmetz, 1977). Managers' tendency to attribute performance shortfalls to problems with the workforce rather than external conditions such as the production system is an example of fundamental attribution biases.

Such misattributions arising from cognitive limitations or from incentive based impression management can both arise at the board level when deciding to retain or dismiss the CEO. Both types of attribution processes can lower the efficacy of CEO dismissal, as the dismissal may not be the appropriate response based on the cause of the downturn, but was driven out of ignorance or self-interest. Causal attributions are influenced by the information to which decision makers attend (Ford, 1985) and perceptions in downturn in performance may vary based on the informational characteristics of the performance. There are many types of performance downturn such as whether the downturn was distinct or gradual. Whether downturn has been consistent across the years a CEO was in office and whether the downturn is common amongst competitors. These three dimensions are core constructs developed by attribution theorists and have been extensively validated in psychology (Jaspers, 1983; Kelley, 1967; Kelley, 1972; Kelley, 1973; Weiner, 1974). Kelley's attribution model provides an inductive logic model which predicts interpretations made by decision makers. While this model is an individual level decision making model, the model has been proven to be applicable at the group level as well (Jaspars et al., 1983). The model proposes three types of information characteristics which affect response time and response action. Three attributional information characteristics are identified: 1) distinctiveness, 2) consistency, and 3) commonality. These three information characteristics of the outcome, which in my study is performance downturn, affect the

dimensions of attributions which are 1) locus of causality, 2) permanence which then affect the response outcome and timing of the response outcome. This is summarized in Figure 3.1.

Figure 3.1 The Attributional Model of Board Response to Performance Downturn



\* Not examined in current study

### 3.1.1 Attributional Information Characteristics as Determinants of Causal Attributions

Causal attributions are influenced by the information to which decision makers attend (Ford, 1985). Decision makers gather and analyze information which they process to evaluate the cause and action of that outcome. This information processing is not unbiased and characteristics of the outcome, the organization, and individual decision makers affect the process (Ford, 1985). My main focus is on the characteristic of the outcome which is performance downturn. Whether decision makers attribute a performance downturn as temporary or permanent, internally caused downturn or externally caused downturn depends in part on the distinctiveness, consistency, and commonality of the downturn (Bettman et al., 1983; Ford, 1985; Kelley, 1967).

***Distinctiveness*** is the extent in which the information of performance downturn is more salient. Keisler & Sproul (Kiesler et al., 1982b) state that people attend to and encode salient material – events that are unpleasant, deviant, extreme, intense, unusual, and sudden as having greater weight in the determinacy of what is remembered and how well it is organized (1982:556). Information salience or distinctiveness significantly biases the interpretation. The amount of information usage affects the interpretation of strategic issues as a loss or a gain (Thomas, Clark, & Gioia, 1993). Ireland, Hitt, & Bettis (Ireland, Hitt, Bettis, & de Porras, 1987) posit that systematic errors occur in managerial decisions and the salience of information leads to different perceptions. Hambrick & Schechter (1993) find that the rate of performance downturn affects the chances of turnaround. A crisis situation might provide a greater sense of urgency to take action because the information is more distinctive. Even with the same 5% drop in sales, if the downturn was steady and gradual rather than abrupt the information perceived by the decision makers would be less distinctive. Rapid performance deterioration is more likely to stimulate timely search for solutions. At the individual level, high information distinctiveness

tends to produce attributions to internal causes in individuals and also influences assessment of stability as permanent (McArthur, 1972). Also, the more salient the information usage, this affects the interpretation of strategic issues as a gain and deems it more controllable (Thomas, Clark & Goia 1993), thus more likely to act on the issue.

**Consistency** is the extent in which the same performance outcome(s) are observed under similar situations over time. Distinctiveness looks at the magnitude in gap from prior years whereas consistency looks at performance volatility across the years. Consistency measures variance in performance across a longer period of time than distinctiveness. Several similar terms such as turbulence (Cameron et al 1987), dynamism (Dess & Beard 1984), instability (Cameron & Whetten 1983) have been used at the environment and firm level to explain fluctuation across time. Miles et al (1974) distinguish between the rate of change and the unpredictability of change positing that turbulence usually creates uncertainty. Researches on the impact of turbulence/inconsistency are rigidity of response, secrecy, and scapegoating of leaders (Withey 1962:118; Staw et al 1981; Pfeffer and Leblebici 1973). Dess & Beard(1984) measured environmental dynamism by the dispersion about the regression line (standard error of the regression slope ) obtained when each dependent variable(i.e. industry sales, employment) was regressed on time over a certain period. – This is considered unsystematic and unpredictable change. I use this same measure at the firm level as explain further in Chapter Four.

Whether the performance is consistently poor or good, consistency supports attribution to internal causes. Thus, high variance in performance (low consistency) even if average firm performance is high is more likely to act fast with CEO dismissal. However, (Bettman et al., 1983; Meindl & Ehrlich, 1987) posit that good jobs are attributed to CEOs and bad to the environment. Thus, high variance may actually increase the charismatic leadership of the CEO

and take credit for good jobs and blame environment for bad. Also, low consistency leads to more uncertainty and decision makers when liable for their actions try to act and handle uncertainty (Miles et al 1974).

**Commonality** is the extent to which other organizations experience similar performance outcomes. As idiosyncratic firm performance increases commonality decreases. Comparing industry median return and market industry return with firm market return. Holmstrom (1982) and Gibbons & Murphy (1990) derive idiosyncratic firm performance apart from common industry performance to test how that idiosyncratic firm performance affects decisions of strategic change. The industry often serves as a benchmark for evaluation of corporate performance (Lambert and Larcker 1985, Foster 1986:225). Controlling for industry performance gives the true CEO skills which impact on corporate performance. The use of benchmarks or references in taking action is supported by research in decision making (Cyert & March 1963; Bamberger & Fiegenbaum 1996). In decision-making theory, individuals may not have the ability to detect or assess opportunities, and thus they rely on only a few cues from available information when making decisions (Hitt and Tyler, 1991; Camerer, 1981).

### **3.1.2 Dimensions of Causal Attributions**

As decision makers structure their environments through interpretation and sense making they retrospectively link events to possible causes (Weick, 1995). Weiner (1979) proposed that each cause can be categorized along three dimensions: 1) locus of causality 2) Degree of permanence and 3) Controllability.

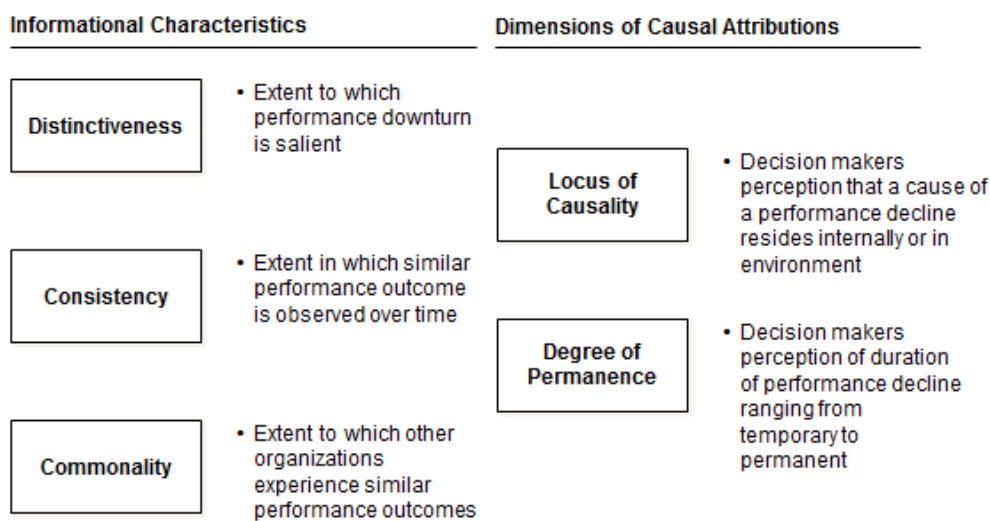
**Locus of Causality** reflects the decision makers' perception that a cause of a performance downturn resides in the environment or situation: an external attribution; or, in the organization,

an internal attribution. The significance of locus of causality is that it “tells” decision makers the source of a cause and where to apply corrective action (Ford, 1985).

***Degree of Permanence*** is a continuum ranging from temporary to permanent that indicates the relative duration that decision makers attach to a cause. Assessments of permanence, therefore, influence decision makers’ motivations to change. If the downturn in performance is seen as a temporary problem of oversupply than decision makers will not feel motivated to change.

Figure 3.1 gives a summary of the three informational characteristics that affect decision maker’s perception through the dimension of causal attributions.

Figure 3.2 Dimensions of Causal Attributions



### 3.1.3 Responses to Causal Attributions

Strategic responses to performance downturn can be fast/proactive or slow/reactive. The response outcome can be a change to an outside CEO successor or inside CEO successor. Depending on how decision makers attribute the cause of downturn in terms of locus of causality and degree of permanence the speed of response and actual outcome response will vary. If the

locus of causality is viewed as internal and degree of permanence as permanent, boards will more likely to act faster in CEO dismissal and hire an outside CEO. If boards view the performance downturn as external and temporary, boards will not be likely to dismiss the CEO or be late in their actions and may select an inside CEO.

High distinctiveness tends to produce attributions to internal causes in individuals and also influences assessment of permanence as permanent (McArthur, 1972). Also, shareholders will be dissatisfied more with steep performance downturn. Subsequently, boards from an impression management standpoint will likely respond more to steeper performance downturn than gradual. Thus, high distinctiveness is expected to produce external locus of causality leading to early response time.

*Hypothesis 1: High distinctiveness in downturn information following an analyst downgrade will increase the speed of CEO Dismissal (i.e. faster).*

Low consistency tends to produce attributions to external causes. Also, if performance is historically volatile, because decision makers have difficulty assessing if result is temporary or permanent they will likely follow historical precedent and attribute downturns to temporary causes (Porter, 1985). Also from an impression management standpoint, someone needs to take the blame for consistent underperformance. Thus, high consistency is expected to lead to slower response time.

*Hypothesis 2: High consistency in downturn information following an analyst downgrade will decrease the speed of CEO Dismissal (i.e. slower).*

High commonality supports attributions to external causes (Weiner 1974). There is little theory on how it will affect the permanence measure in psychology literature. However, if the downturn is common amongst all firms it is likely that firms will perceive the cause as being external. And if all the firms in an industry are doing poorly there is less reason to blame someone for it. Many previous CEO turnover studies (Weisbach 1988, Parrino 1997, DeFond and Park 1999) find evidence suggesting that board members filter out industry effects in performance measures. Others suggest that boards have difficulty in doing such and take industry downturn as a way to fire CEOs – even though it may not be their fault (Bushman 2010). Overall, high commonality is likely to be assessed as the cause being external, therefore giving the CEO some more time.

*Hypothesis 3: High commonality in downturn information following an analyst downgrade will decrease the speed of CEO Dismissal (i.e. slower).*

### **3.2 Consequences of Speed of CEO Dismissal on Post-Succession Firm Performance**

Charles Lucier of Booz Allen Hamilton (2008) stated that “Business has entered the era of the short term chief executive”. However, the time it takes for an organization to replace poorly –performing has not been rigorously examined nor has the consequences. Castrogiovanni et al (1992) argue in their conceptual paper that when to replace a CEO should vary by downturn stage. As downturn progresses, the credibility of the CEO decreases and dissatisfaction from shareholders, employees, investment analysts, and other stakeholders intensify. Subsequently, the need for change in action increases.

However, shareholders and other stakeholders should realize the costs to CEO change. Costs of changing include severance pay to the former CEO and disruptions incurred as a new CEO adjusts to his/her role accompanied by employee resistance to change. Productivity may downturn as employees adjust to changes prescribed by the new CEO. Uncertainties about the new CEO and future of the firm may increase stress and decrease employee morale. For these reasons, firms should not be too quick to replace their current CEOs. Miller and Friesen (1980) show that firms tolerating short-term performance downturn and making dramatic strategy changes only after long-term downturn tendencies became apparent outperform firms making frequent and incremental strategy changes. Similarly, replacing CEOs in response to short-term performance problems may in fact inadvertently penalize the firm. Khurana (2002) posit that crises are often the worst times to seek charismatic saviors. He posits that when corporate performance falters, boards frequently misdiagnose problems, fire incumbents and search for charismatic successors often leading to disappointing results.

Benefits of CEO dismissals are that the new CEO will have a fresh perspective of the business problem and infuse appropriate change. Second, it will act as a positive signal to shareholders. Incumbent CEOs may not be able to strategically change the firm even if they want to because of myopic vision and may not have the skills needed for a turnaround. Skills needed for turnaround may be different from those needed to maintain performance (Castrogiovanni et al 1992). Chung (1987) also mentions that replacing the CEO is the most dramatic way to signal a willingness to change. However, such scapegoating may not help the firm if the CEO was not the direct cause of the downturn. Considering costs of CEO change as mentioned above, scapegoating should incur in negative post-succession downturn. However, as downturn

progresses the need for change will intensify and credibility of the CEO will decrease. Boards will have the need to act and blame someone.

Most scholars view dismissal as being too late because of CEO entrenchment (Finkelstein et al 2008). It is likely that powerful CEOs may act opportunistically leading to underperformance. In such cases, even though the CEO is the cause of downturn, it would be difficult to fire the CEO. Even if entrenchment is not the case, keeping an unqualified CEO over long durations of underperformance may cause unrecoverable damage. Daveni (1988) posit that firms losing the time to turnaround in early stages may incur a downward spiral. In a downward spiral, external constituents pull out support from the firm leading to irrevocable downturn.

Thus, balancing the costs and benefits of CEO change, there should be an optimal time in which CEO dismissal should occur after start of downturn. Too early dismissals from short term responses without considering costs of change will lead to lower post-succession performance. Especially if early dismissals arise from misattributions and scapegoating as mentioned earlier post-succession performance will be even worse. Too late dismissals will occur mostly from CEO entrenchment. In such cases a downward spiral might have begun and changing the CEO might be too late. As such, the following hypothesis is derived:

*H4: Speed of CEO dismissal will have an inverted-U relationship with post-succession performance.*

### **3.3 Trend and Sarbanes-Oxley Effects on Speed of CEO Dismissal**

In wake of the corporate scandals such as WorldCom, Enron etc. legislation has been introduced in 2002, the Sarbanes-Oxley act, which requires additional corporate board responsibilities. The legislation set new or enhanced standards for all U.S. public company

boards. Prior research shows that shifts in regulatory (Smith & Grimm 1987; Cho & Shen 2011) or technological environments (Tushman & Anderson 1986) motivate important strategic changes in organizations.

While the CEO once dominated the boards, increasingly it is now boards that monitor closely CEOs performance and also engage in strategic direction making. Judge & Zeithmal (1992) posit board of directors' involvement in strategic decision making has increased as an institutional response. As corporate boards are legal entities governed by state law, increased litigation has been directed at boards (Kesner & Johnson 1990). As such, boards are pressured to act when firms are underperforming. Growing levels of shareholder activism leads to greater and faster likelihood of executives being dismissed for poor performance. Boards in general will attribute poor performance to internal rather than external causes, especially when they are liable for it (Miner 2005). The situation then begs the question of are boards just doing something or are they doing the right thing when dismissing CEOs? If boards are indeed getting rid of unskilled and entrenched CEOs post-succession performance for firms which have dismissed CEOs in the post Sarbanes-Oxley era will be higher. However, if the boards' response was due to impatience and short-termism post-succession performance will be lower. The effects of the Sarbanes-Oxley legislation provide contrasting predictions:

*H5: Speed of CEO dismissal in declining firms has increased (i.e. faster) post Sarbanes-Oxley legislation*

*H6a: Post-succession performance will be lower for dismissal post Sarbanes-Oxley legislation*

*H 6b: Post-succession performance will be higher for dismissals post Sarbanes-Oxley legislation*

## **CHAPTER FOUR: RESEARCH METHODOLOGY**

This chapter provides a description of the methodology used to test the hypotheses developed in Chapter three. Accordingly, the following is organized into three sections: (1) sample selection process and data sources; (2) measurement of primary variables; and (3) overview of the statistical methods used for testing the hypotheses.

### **4.1 Data Sources and Sample Design**

I use both qualitative and quantitative data for this study. Interviews were conducted with three board members serving on various corporate boards in North Carolina. The interviews serve the purpose of understanding the context of CEO dismissal and validate the major assumptions and propositions. Guided by a case-study protocol, open-ended questions were used in the interview. A copy of the protocol and research questions is provided in Appendix 1. Each interview lasts about one hour. All interviews were attended by two researchers. Notes were taken during the interview by both researchers and compared after interview to make sure the understanding and interpretation of the qualitative data is uniform. Results from the qualitative analysis are presented in Chapter Five.

The quantitative data was collected from multiple sources. The sample of firms used in this study includes all publicly-traded corporations that satisfy the following criteria.

1. The firm is included in the *Execucomp* database during the 1996-2009 period.<sup>3</sup>
2. The firm is included in the *Institutional Brokers Estimate System (I/B/E/S)* and has experienced a downgrade in analyst ratings.<sup>4</sup>
3. Financial statement data are available on the *Compustat* database and return data are available on the *CRSP* database.
4. Boards of Directors data are available on the *IRRC directors (Risk Metrics)* database.

The choice of sample was dictated by the need to identify firms that are monitored by the investment community. Thus, the sample consists of large, publicly traded firms in the United States. Financial and public utility firms (SIC codes 4800-4999, 6000-6999) were excluded because government regulations potentially affect large shareholder ownership and influence corporate governance. Boards of directors' information are typically readily available for public firms as provided in the Securities and Exchange Commission (SEC) reporting requirement.

I tracked data for each sample CEO observation from the start of CEO tenure until the end of 2009 or until the date the CEO was dismissed. I took note of whether the CEO was dismissed due to bankruptcy, de-listings, buy-outs, or acquisitions. In order to assess post-succession performance, I also collect future ROA and abnormal stock return data two and three years following CEO dismissal. All observations with no CEO dismissal are excluded for this part of the analysis.

In order to measure time to CEO dismissal of declining firms, the start of downturn should be a standard measure for each firm. Because how long a duration of prior year

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<sup>3</sup> *Execucomp* is a subset of the compustat database offered by Wharton Research Data Services (WRDS). This database lists annual CEO information, including CEO turnover data during the 1992-2009 period. Because IRRC data was only available for the 1996-2005 period my sample is limited to that time period.

<sup>4</sup> The downgrade must take place after a known start date of a CEO.

performance information boards of directors use to evaluate their CEOs is not known, I propose using an external measure of downturn which is investment analyst evaluations.

Analyst ratings of the stock of the firm (Strong Buy, Buy, Hold, Underperform and Sell) are issued monthly.<sup>5</sup> Change in ratings is not frequent, especially for downgrades (Womack, 1996), and thus can be seen as a valid inception point and measure of downturn. This assumption was partially validated by interviews with board members. A downgrade in rating signals that the investors view the firm as problematic and in need of change. As many investment analysts may cover a firm, I use the negative change in consensus rating as a sign of potential problems.

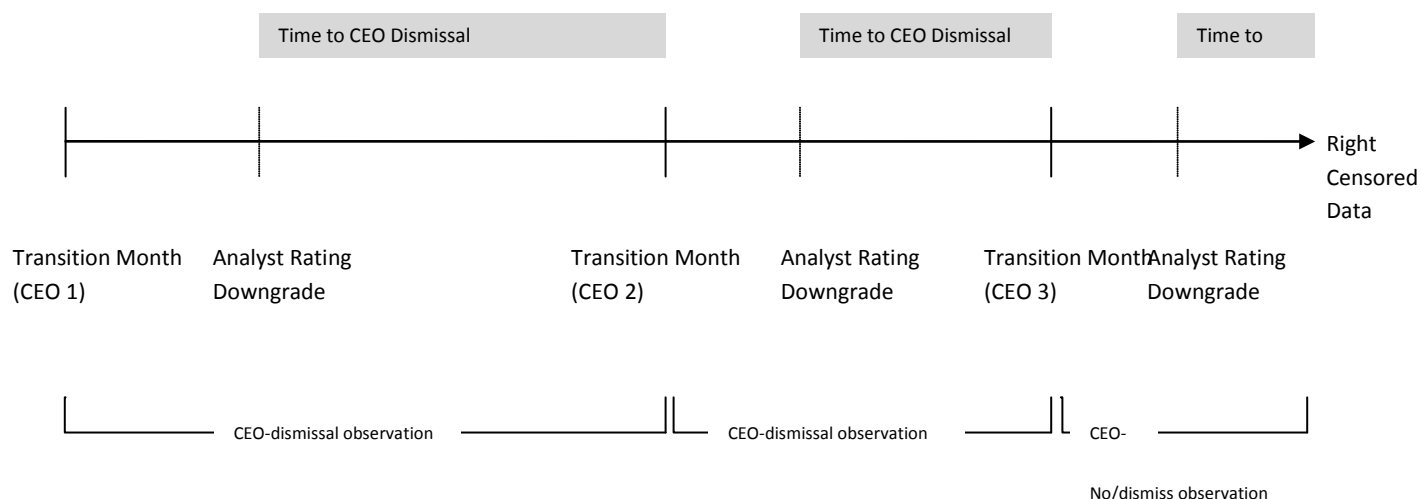
Because a change in analyst ratings has significant impact on stock price and investor demand on the firm's stock (Chung & Jo, 1996; Irvine, 2003; Stickel, 1992; Womack, 1996), it is likely that boards will use analyst forecasts as a proxy for information (Puffer et al., 1991). Although an uncertain signal, an analyst downgrade will bring to the attention of boards that a problem may exist. After such incident, boards will try to figure out the causality of the problem<sup>6</sup>. Thus, how the CEO reacts and resolves the issue after such downgrades is critical information to the board of directors and financial firm performance will be the core metric for evaluation. As such, I control for firm performance following the downgrade. Though not frequent, because there can be more than one rating downturn throughout the CEO's tenure, I use the first downturn in rating since the start of the incumbent CEO tenure because it shows the first sign of trouble. A graphical picture is given in Figure 4.1 for clearer understanding.

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<sup>5</sup> Security analysts' ratings can be obtained from reports issued by individual analysts or by reports of services that collect and distribute earnings ratings made by analysts. The IBES surveys individual financial analysts from the research departments of leading Wall Street and regional brokerage firms. IBES collects not only security analyst ratings but earnings per share forecasts.

<sup>6</sup> Interviews with three directors serving on over fifteen corporate boards show that board members view analyst ratings seriously and use supplementary information to confirm or disconfirm the prospects and skills of the CEO conveyed by the firm's analyst ratings.

Figure 4.1 Measurement of Speed of CEO Dismissal in Response to Analyst Downgrade



## 4.2 Key Variables and Measures

### 4.2.1 Dependent Variables

The dependent variable for Hypotheses 1-3 and 5 is the speed of dismissal. Speed of dismissal was measured as the time it takes to fire a CEO after the first analyst downgrade during one's tenure. First, I need to identify and classify whether CEO turnover is truly a forced dismissal. This is a major challenge in succession research because firms seldom fully disclose the true reasons behind CEO resignations (Denis et al., 1995; Fredrickson et al., 1988). Recent work has thus used several approaches to better identify CEO dismissals and distinguish them from voluntary turnovers or retirement (Parrino, 1997; Shen & Cannella, 2002a; Wiersema et al., 2008). Based on such recent approaches I classify forced dismissals as all CEO changes other than those arising from retirement, death, illness, or those involving the CEO's departure for a prestigious position elsewhere. In assessing the nature of the CEO succession, I follow prior studies using age at departure. I identify from the *Execucomp* database whether CEOs have reached the retirement age of 64 years old. I assume a voluntary retirement for any departing

CEO at least 64 years old unless I later uncover information suggesting otherwise. Next, if the CEO keeps directorship or the title of chairman after retirement I do not treat the observation as a dismissal (Shen & Cannella 2002). Third, for the observation coded as “retired” or “unknown” on the *Execucomp* database I go through news articles from *Factiva* and *Google* search to uncover information behind the departure. I consult the full article pertaining to the announcement of CEO departure. Also, I search articles up to two years prior to and one year post the CEO departure to look for words such as “poor management”, “performance problems”, and “board conflicts”. Last, if the CEO departs due to bankruptcy, delistings, or acquisitions I do not classify the CEO as being dismissed and is not included in my sample. After assessing the nature of the CEO succession, the speed of CEO dismissal is measured counting the time it takes to fire a CEO. Thus, the speed of dismissal is defined as the number of days between the last consensus stock recommendations having a downgrade until the CEO leaves the office.

I model dismissal as a time-dependent binary event. The dependent variable is the log of time-to-dismissal. Facing two issues with the data, one, that there are a number of censored observations and two, the probability of dismissal may increase with the length of time the CEO has not be fired I use a hazard function to model speed of CEO dismissal . I use a parametric method to model the effects of independent variables on time-to-event, i.e. speed of dismissal (see chapter 5).

The dependent variable for Hypotheses 4 and 6 is post-succession firm performance. Table 4.1 shows the summary of measures for the depend variables of my analyses. Following Virany et al., 1992 and Beoker & Goodstein 1993, I explore the effects of succession on firm performance by measuring percentage change in industry adjusted ROA and market adjusted stock return between the year of succession and three years subsequent to succession. A three-

year interval was employed to provide a time period long enough to permit changes to take place, but short enough not to be confounded by other factors. I also explore two-year ROA and stock return differences as a robustness test and find little difference. When examining post-succession firm performance, the speed of CEO dismissal is used as the main explanatory variable.

**Table 4.1** Dependent Variable Definition and Measure

Variable	Definition	Measure	Source
Speed of CEO Dismissal	The time it takes for boards to respond to an analyst downgrade by firing the CEO	The log of the number of days between the last consensus stock recommendation having a downgrade until the CEO leaves the office	Compustat/ IBES
Change in Industry Adjusted ROA	The change in industry adjusted ROA between the average ROA one year prior to CEO dismissal and the average three years after CEO dismissal	Industry adjusted ROA is the firm ROA less industry ROA, where the change in ROA is the twelve month average ROA before CEO dismissal less the 36 month average ROA following CEO dismissal	Compustat
Change Abnormal Stock Return	The change in market adjusted ROA between the average abnormal return one year prior to CEO dismissal and the average three years after CEO dismissal	Market adjusted return is the firm return less market return, where the change in stock return is the twelve month average return before CEO dismissal less the 36 month average return following CEO dismissal	CRSP

#### 4.2.2 Independent Variables

For hypothesis 1-3 the core independent variables are different types of performance feedback following an analyst downgrade. I develop three measures of performance types. The extent of *distinctiveness* was measured by calculating average change in abnormal stock return over the period of downturn (first analyst downgrade) to CEO dismissal or until the end of my study (year 2009). Monthly return data is collected for all firms during that period. Average change in abnormal stock return is used to capture the magnitude of performance change across that time<sup>7</sup>. Instead of using the slope of downturn using two time points

<sup>7</sup> Because the number of months from analyst downgrade to CEO change will vary for firms, this may be confounding. Because early dismissal may not leave sufficient degrees of freedom the distinctiveness, consistency, and commonality estimates may not be robust.

$(\frac{Return_{dismiss}-Return_{downgrade}}{Time})$ , I utilize my monthly data to obtain average change in abnormal stock return over the period of interest. This is equivalent to the regression slope coefficient ( $\beta$ ) obtained when abnormal return is regression on time (month) over the period of downgrade to CEO dismissal (or end of study).

The extent of **consistency** is measured by using Dess & Beard's (Dess & Beard, 1984) measure of environmental dynamism at the firm level. It is measured by the dispersion about the regression line. This is calculated as the standard error of the regression slope coefficient obtained when abnormal stock return is regressed on time over the duration of first downgrade rating and CEO dismissal (or end of study) divided by mean value of abnormal stock return during the duration ( $\bar{Y}$ ).

The extent of **commonality** can be measured by regressing change in firm abnormal stock return on change in industry abnormal stock return over the duration first downgrade rating to CEO dismissal (or end of study). The beta coefficient of change in industry performance will give a continuous measure of the degree of commonality. If the beta coefficient is higher, the commonality is higher.

$$\Delta Return_f = \alpha + \beta \Delta Return_i$$

**Table 4.2 Independent Variable Definition and Measure**

Variable	Definition	Measure	Source
Distinctiveness	Magnitude of firm performance change during the period of analyst downgrade to CEO dismissal	Beta coefficient from the regression of monthly stock return on time	CRSP/IBES
Consistency	Volatility of firm performance during the period of analyst downgrade to CEO dismissal	Standard error of the the beta coefficient from the regression of monthly stock return on time. The larger the standard error the less consistent the movement of stock return with respect to time. Thus, the measure itself is more a measure of inconsistency	CRSP/IBES
Commonality	The extent of commonness of firm performance and industry performance	Alpha coefficient from the regression of monthly individual stock return on monthly industry stock return. This measure is the portion of firm's stock return that is unrelated to the industry stock return. Thus, the measure is more a measure of uncommonality	CRSP/IBES

Corporate governance variables were included as control variables when examining the antecedents of speed of dismissal. These variables were also included to run regressions for generating the excess time variables needed for examining performance consequences of speed of dismissal (see 4.3.2 section). These variables are gathered from the RiskMetrics database (IRRC directors). ***Fraction of independent (outside) board members*** (Weisbach 1998) is measured as the ratio of independent directors to board size calculated at the end of the fiscal year prior to analyst downgrade. Prior researchers (Cannella et al., 2001; Zajac et al., 1996) find that stronger boards with more independent directors increase the probability of CEO turnover. ***Board size*** is the number of directors on the board which was calculated at the end of the fiscal year prior to analyst downgrade. Prior research (Zajac et al., 1996) find that larger boards affect CEO turnover decisions. ***CEO duality*** is whether the CEO is also the chairperson of the board. A dummy variable of 1 is given if the two positions are separated and 0 otherwise. Prior literature suggests that separating CEO and board chair positions give more power to the board of directors over the CEO (Finkelstein & D'Aveni 1994). Thus, less entrenchment will increase the likelihood of CEO dismissal (Huson, Parrino, & Starks, 2001). ***Gompers index*** is a measure

of the level of takeover and other protection insulating the CEO from external control markets. A lower Gompers index is more likely to be proactive in CEO dismissals (Gompers, Ishii, and Metrick 2003). CEO characteristics are collected from the ExecuComp database. **CEO Ownership** is defined as the average of the sum of stocks and option owned by the CEO during the time to dismissal period scaled by the total number of stock outstanding. (Morck, Shleifer, and Vishny 1989). I control for the stock ownership of the firms' CEO since large ownership positions, by conferring greater power to the CEO, have been found to be negatively related to the likelihood of CEO dismissal (Huson et al., 2001; Shen et al., 2002). CEO stock ownership may also affect inside/outside succession (Boeker et al., 1993). Greater ownership gives the CEO more bargaining power because of associated voting rights, reducing the chance of the CEO being forced to leave (Morck, Shleifer, & Vishny, 1989). Also, CEO ownership is positively associated with higher firm value thus must be controlled for (Griffith, 1999). Managers having higher levels of ownership are more likely to act in shareholder interests (Jensen et al., 1976). **CEO Age** is the average of the CEO age during his tenure. **CEO Origin** is defined as whether the CEO comes from inside or outside the firm. The outcome of a previous succession event – whether an insider or outsider was named- can affect a current succession (Fredrickson et al 1988, Ocasio 1999). Dalton and Kesner (1985), following the approach of Helmich, defined an insider as an employee promoted from within a firm and an outsider as any other individual. If the CEO had been an employee for more than 1 year at the firm before becoming a CEO, I define that individual as an insider. All else, is defined as an outsider. **Firm size** is measured as the average market value of equity and market-to-book ratio during the time to dismissal period. I control for *firm size* since larger firms, by virtue of their more extensive shareholdings, will be more closely scrutinized by the financial community. Earlier studies have examined firm size as

a determinant of likelihood of CEO dismissal and as a determinant of inside/outside succession (Dalton et al., 1985; Huson et al., 2001). Although many of these variables are time dependent, because my parametric hazard model can only incorporate time-invarying covariates I choose an average or a point in time for the measures.

**Table 4.3 Control Variable Definition and Measure**

Variable	Definition	Measure	Source
Recommendation Drop	Magnitude of stock recommendation drop	The first mean of consensus analysts' stock recommendation after the CEO start date that is below the last mean consensus stock recommendation prior to the CEO start date minus the last mean stock recommendation prior to the CEO start date	IBES
Abnormal Return	Current stock based firm performance which is the value weighted market adjusted return during the CEO tenure period following the first downgrade	Abnormal return is the firm return less the market return measured monthly	CRSP
ROA Change	Current accounting based firm performance which is the average ROA during the CEO tenure period following the first downgrade minus the average yearly ROA prior to the first downgrade date	Average net income divided by total assets during the CEO tenure period following the first downgrade minus the average yearly ROA prior to first downgrade	CRSP/IBES
Duality	CEO holds chairman position	An indicator variable that is 1 if the CEO also serves as the chairman of the board of directors and 0 if otherwise	RiskMetrics
Board Independence	Proportion of independent (outside) board members	Ratio of outside board members during the CEO tenure period following the first downgrade	RiskMetrics
Board Size	Size of corporate board	Number of board members	RiskMetrics
CEO Ownership	Total compensation of CEO	Average salary, bonus, LTIP plus sum of stock and options scaled by the total number of stocks outstanding during the period following downgrade	Execucomp
CEO Age	Age of CEO	Average age of the CEO during the period following first downgrade	Execucomp
CEO Origin	Insider or Outsider	Indicator variable which is 1 if the CEO had been employed by the firm(insider) for more than one	Execucomp
CEO Gender	Male or Female	Indicator variable that is one if the CEO is male and zero otherwise	Execucomp
Firm size	Market value	average market value of equity during the period following first downgrade	Compustat
Market to Book	MB ratio	average market-to-book ratio during the period following first downgrade	Compustat

## 4. 3 Methodology

### 4.3.1 Examining the Antecedents of Speed of CEO Dismissal

In examining hypotheses 1-3, I use a hazard function to model speed of dismissal. A hazard model is often used in measuring failure times or, in my case, time to CEO termination. A hazard model is particularly valuable when there is right censoring and because it incorporates time at risk. Prior studies that have used CEO turnover to understand corporate governance have relied on logit analysis (Denis et al 1997, Hambrick 2005). However, Shumway (2001) shows that cross-sectional logit is an inconsistent estimator of the probability of termination because it does not account for time at risk. The risk that the CEO will be fired given that s/he has stayed this long.

There are two general approaches to estimating the hazard function: the proportional hazard model (COX model) and the accelerated failure time model (AFT model). The advantage of the proportional hazard model is that the coefficient vector can be estimated without specifying the baseline hazard function. The results of AFT models are easily interpreted because projected survival probabilities may be derived. AFT gives time ratios not hazard ratios – a more direct interpretation of the estimated coefficient. Cox said, “accelerated failure models are in many ways more appealing” than the proportional hazard model “because of their quite direct physical interpretation” (Reid, 1994).

The main drawback of AFT models is the need to specify the distribution that most appropriately mirrors that of the actual survival times – thus called a parametric model. Where a suitable distribution can be found, however, the AFT model is more informative than the Cox model. It is straightforward to derive the hazard function and to obtain predicted survival times when using a parametric model, which is not the case in the Cox framework. Additionally, the appropriate use of these models offers the advantage of being slightly more efficient; they yield more precise estimates (i.e. smaller standard errors). The regression parameter estimates from

AFT models are more robust to omitted covariates. They are also less affected by the choice of probability distribution.

The time-to-dismissal from first analyst downgrade of CEO tenure in a firm  $T$  is a random variable with a probability density  $f(t)$  and a cumulative density  $F(t)$ . The likelihood that a CEO is dismissed, given that s/he has not been dismissed in the interval  $[0, T]$ , is

$$h(t) = f(t)/(1 - F(t))$$

I can use a nonparametric method to model the effects of covariates on the hazard, or parametric methods such as the accelerated failure time approach to model the effects of independent variables on time-to-event, i.e., dismissal. For the given reasons, I opt to use an AFT approach. In the accelerated failure time approach, the hazard of takeoff is of the form

$$h_i(t, X_i) = \exp^{aX_i} h_0(\exp^{aX_i} t)$$

i.e., the impact of independent variables on the hazard for the  $i^{\text{th}}$  observation is to accelerate or decelerate time-to-dismissal as compared to the baseline hazard (Srinivasan et al. 2004). An easier way of estimating this model is to write it as follows which can be thought of as similar to a regression model:

$$Y = X\beta + \sigma\epsilon$$

Where  $Y$  is the vector of the log of time-to-dismissal,  $X$  is the matrix of covariates which includes main explanatory variables (distinctiveness, consistency, commonality), governance variables (fraction of independent directors, board size, CEO duality CEO ownership), CEO characteristics variables (age, tenure, origin) and other controls (firm size),  $\beta$  is a vector of unknown regression parameters,  $\delta$  is an unknown scale parameter, and  $\epsilon$  is a vector of errors, assumed to come from a known distribution such as normal, log-gamma, logistic, extreme value

forms leading to the log-normal, gamma, log-logistic, or the Weibull/exponential distributions for T, respectively. I use PROC LIFEREG in SAS to estimate this model (Allison 1995). The estimation is done via maximum likelihood.

The choice of the functional form for the distribution of the error term is important since it determines the shape of the hazard function. I use the generalized gamma distribution because it allows the greatest flexibility in the shape of the hazard function and includes the exponential Weibull and log-normal distributions as special cases. The exponential distribution has a constant hazard function, so that the time-to-dismissal does not depend on time (tenure). The Weibull distribution has a hazard function that is either strictly increasing or strictly decreasing. A strictly increasing hazard would be consistent with board's becoming less tolerant of the CEO as time progresses. A strictly decreasing hazard would be consistent with the CEO gaining power over the board as time progresses. The log-normal distribution has an inverse-U shaped hazard function. An inverse U shape is implied with Ocasio's power of circulation theory (1992) where the CEO takes some time to gain influence over the board. Overall, I find the log-normal distribution and present the result in chapter six. Chapter six will show which distribution best describes the data.

#### **4.3.2 Examining the Consequences of Speed of CEO Dismissal**

As the ultimate goal of this part is to examine the relation between time it takes to dismissal which is unrelated to the firm's performance and future firm performance, I define a variable called '*excess time*'. The definition of *excess time* is the portion of time to CEO dismissal unrelated to the firm's performance and governance. I first measure *excess time* using the residual from the OLS regression of the determinants of speed of CEO dismissal. I generate three measures of excess time each controlling for firm performance, strength of governance and

other controls. Next, using the excess time measures I divide the sample into three categories of slow, medium and fast. I next use the three categories and see the relationship with future firm performance to examine which category has the best post-succession firm performance.

#### **4.3.3. Examining the Trend and Sarbanes Oxley Effects of CEO Dismissal**

In this section, I examine the speed of CEO dismissal by fiscal year to graph a trend line. Next, I divide the sample into CEOs that have been dismissed prior to the SOX enactment and post the SOX enactment. A t-test and Wilcoxon test is used to compare the means and medians between speed of dismissal for the pre-SOX dismissals and post-SOX dismissals. I also examine the post-succession firm performance of the pre-SOX dismissals and post-SOX dismissals. The mean and median difference was also tested using the t-test and Wilcoxon test.

## **CHAPTER FIVE: INTERVIEWS AND QUALITATIVE DATA**

In this chapter, I report from interviews with three members of board of directors that have served on various public and private firms. Although the number of interviewees is small, these board members have extensive experience governing over a total of fifteen firms. Therefore, evidence accumulated across several firms and different situations provides added validity. The interviews were conducted to strengthen the grounding of theory by triangulation of evidence. Using prior literature as the basis for building theory, the interviews were used to validate that my research questions and constructs I am examining are legitimate. Through the interviews, I was able to confirm assumptions and build internal validity of my hypotheses. The broad research questions explored are the following:

- How often is the CEO monitored and evaluated? Is there a time in a CEO's tenure in which s/he is more prone to being evaluated more attentively?
- What kind of performance measures and signals are used in the evaluation of the CEO?
- What kind of information does financial analyst ratings portray?
- Did regulatory changes and trends affect the behavior of the board of directors?

I was careful not to bias the interviewee in order to confirm my theory and hypotheses. I took the approach provided by Yin (1984) and Eisenhardt (1989) and kept the questions generally open to retain flexibility in the answers. The selection criteria for interviewees was simply that the interviewee has to have held a board of director position at a public firm and has experience

evaluating the CEO of the firm. The interview was conducted with advisor Hugh O'Neill. The notes were retyped and compared in order to provide accuracy. The survey used is in appendix 1.

## **5.1 Interview Members**

I was able to conduct interviews with three executives, anonymously listed below due to confidentiality agreements, currently holding board of director positions at public firms.

1. Board member A: Chairman of the board of directors and partner of North Carolina based investment firm. Served as board member for over nine public and non-profit firms. Has experience with CEO dismissal while serving on corporate board.
2. Board member B: CEO and Chairman of a pharmaceutical company. Held various executive positions at public and private firms.
3. Board member C: Current board member of two public firms. Served on boards of over five energy and telecommunications firms. Several of the firms were in a turnaround situation while he served on corporate board.

## **5.2 Interview Results and Findings**

The findings I extracted from the interviews are as follows:

1. Functions of the board change based on performance. Bad performance leads to more frequent checks, use of sub committees, and closer monitoring of CEO.

*“When a firm is doing really well boards have a relatively easy job. We are happy and just deal with issues that come up such as routine succession. When a company is not doing*

*well boards look for a lot more detail. ... gets increasingly critical as problem persists. They spend a lot more time.” – Board member A*

2. Financial performance is most important. Performance measures can be financial performance, budgets, market share, external events, and industry performance. Depending on the industry, different performance metrics can be used (i.e. for pharmaceutical companies progress in clinical programs, time based process checks, FDA approval)

*“Everything pales compared to firm performance. If the company is doing well financially. The board will put up with an awful lot. If a firm is doing great, growing faster than competition, and the CEO is, let’s say he is socially kind of a diamond in the rough and not a guy you’d like to see your daughter marry, but if the firm is doing well, you’d have a terrible time getting rid of that CEO.” –Board member A*

3. Using share price as a predictor of firm performance and CEO performance was viewed as important by two board members whereas the CEO/Chairman said that share price is not important and is surely not indicative of CEO performance.

*“ Market is irrational and share price is a bad predictor. Is it the CEOs fault that stock plummets 35% after products get FDA approval? “ – Board member B*

4. Different types of performance (distinctiveness, consistency, commonality) have individual effects on the decision to 1) raise issue of whether the firm/ CEO should be monitored more closely 2) contemplate if the CEO should be retained or fired 3) finalize on the decision to fire a new CEO. The terms such as persistence, compared to competitors,

sharp downturns were used when mentioning firm performance, thus indicative that these specific performance measures are used in evaluation of firm/CEO performance.

Consistency: “ *If problem persists it’s hard not to fire. Even if you get somebody else and he does worse you’re almost forced to make a change.* ” - Board member A

“*When the company is not doing well the board gets increasingly more critical as the problem persists. They spend a lot more time.*” – Board member B

“*A down quarter may not be enough but if down years persist you have to decide whether to let the CEO stay or not.* ” – Board member C

Distinctiveness: “*early signals of bad performance is dramatic stock decrease*” – Board member B

Commonality: “*Competitor comes out with new product this triggers questions.*” – Board member B

“*Examine if business is growing with industry.*” – Board member C

“ *Financial performance and competitive status is the key metric – even if you don’t like the guy you can’t fire.*” – Board member A

5. The timing of CEO is almost not explicitly of concern. Board member A said that most CEOs are never fired too early but rather always too late. In contrast, board member C thinks they are alert enough to intervene before things get bad. However, there was a case when “not good behavior” was only noticed when the CEO was about to retire and truncated his time. This could be a case of “too late”.

*“gets so bad as they don’t want to stay on the board they are encouraged to change the CEO and say they did their job as board members. However, people try to avoid it. “ – Board member A*

6. Analyst ratings and external news reporters are useful signals of firm performance and CEO performance. Downgrades sometimes come as surprises and CEO’s are monitored more closely and how a CEO responds to the downgrade is examined. Many comments show that boards are relatively late in their information than managers and do use analyst information. However, the cause of the downgrade and how a CEO responds was a more critical issue than the downgrade itself.

*“ newspaper reporter got wind of some news and began asking questions. This triggered boards to pay attention. “ – Board member C*

*“ analysts provide very good information, we ask what are we missing? I thought analysts were sometimes wrong because they didn’t give much credit for investment in South America. Ultimately we sold it and selling was a good decision” – Board member C*

*“If you’ve been doing very well.. and analysts were expecting you to grow 18~20% you get downgraded because you grow 10~12%. Frankly most board’s don’t care. It’s not a big deal. Who cares? The board cares about what causes the downgrade and how a CEO responds. “ - Board member A*

*“ Even if it’s not the CEOs fault. It’s on his watch. “ – Board member A*

7. One example, told by board member A, about a board member resigning because of conflicts with the CEO shows that board members may resign when the CEO has relatively more power than board members. Board member A quotes that the CEO did not like diversity in board members nor did he want them to be active in their involvement. He wanted followers.

*“ Ed (anonymized) is a follower he will be a good board member. I need difference but nothing extreme. Boards need to be active to an extent where it’s not deficient to the management. ... They should not be in control. Sometimes boards use CEOs for their own interest. I have faced angry hostile shareholders. After talking with them if they are not satisfied ask them to go elsewhere. “ – Board member B*

*“ If the board is unhappy with the CEO but can’t do anything he resigns. I quit from a board because I didn’t like the way the guy was running the company. “ – Board member A*

8. There are more human aspects than straightforward logical in making the decision to retain or fire a CEO.

*“ Even if it’s not the CEOs fault. It’s on his watch. No one wants to do the dirty job and fire the CEO. “ – Board member A*

9. Regulatory trends and SOX may or may not matter. Several say they are more alert others say the regulations have more to do with the internal audit department than board members. However, there were comments on how boards are held liable and have to be careful with actions.

*“ We are more alert and rigorous after SOX. We need to demonstrated processes and be more objective.” – Board member A*

*“There isn’t that much impact on us. However, because of the processes in place we do find some surprises. There is a tendency to limit CEO tenure.” – Board member C*

*“Laws are selling air. You cannot legislate honesty. The regulations don’t have much effect on evaluation of the CEO. “– Board member B*

### 5.3 Evidence for Hypotheses Support

Overall, I found evidence for most of my hypotheses. However, given the small number of interviewees, within case analysis is not sufficient for finding cross-case patterns. The interviews were more for providing description and evidence of existence (Kidder 1982). Also, the interviews show that an analyst rating are of important information and validates that future firm performance following a downgrade and how a CEO responds is critical information. One interviewee also cautioned that over 90% of CEO exits previous to retirement age are probably “suggested exits”.

**Table 5.1. Evidence for Hypotheses**

<b>Hypothesis</b>	<b>Confirmation</b>	<b>Evidence</b>
H1	(+)	Distinctiveness – Construct mentioned as performance metric of evaluating the firm and CEO
H2	(+)	Consistency - Construct mentioned as performance metric of evaluating the firm and CEO
H3	(+)	Commonality - Construct mentioned as performance metric of evaluating the firm and CEO
H4	(?)	Speed of dismissal and future firm performance will have inverted U shape relationship – Not explicitly mentioned but there were cases of CEOs being fired too late
H5	(+)	Speed of dismissal will increase after SOX – Comments on how there is a tendency to limit CEO tenure in recent years but not explicitly on faster
H6	(?)	Post succession performance after SOX will increase. – Comments on how internal auditing processes are more in place. But also that honesty cannot be regulated

## **CHAPTER SIX: ANALYSIS AND RESULTS**

I have split the analysis of the data into three parts. First, I analyze how different types of performance feedback affects the time it takes for corporate boards to fire the CEO outlined in Chapter three. This analysis is based on all CEO-firm pair observations that have incurred at least one analyst downgrade during the CEO's tenure. Second, I analyze whether the speed of dismissal following an analyst downgrade has an effect on post-succession firm performance. This part is explored using descriptive statistics and also some confirmatory data analysis. Third, I analyze how the speed of CEO dismissal has changed before and after SOX enactment. I compare the speed of CEO dismissals that have occurred before the 2002 SOX enactment and the speed of CEO dismissals that have occurred after. I end this chapter by giving a summary of all the hypotheses and their results.

### **6.1 Data Overview and Descriptive Statistics**

The descriptive statistics provide an understanding of the speed of CEO dismissals and corporate governance characteristics of the firm. I first report the frequency distribution in Figure 6.1 of "speed of CEO dismissal" to examine if there exists variance in the variable. The figure exhibits a distribution where CEOs are fired frequently during the first four years following a downgrade. The highest frequency occurs at one and two years and decreases slightly at three years and increases again at four years showing a tendency that CEOs get fired quite early after a

performance downgrade or are given a few more years to improve performance. 62.7% of CEOs are fired during the first four years.

**Figure 6.1: Distribution of Speed of CEO Dismissals**

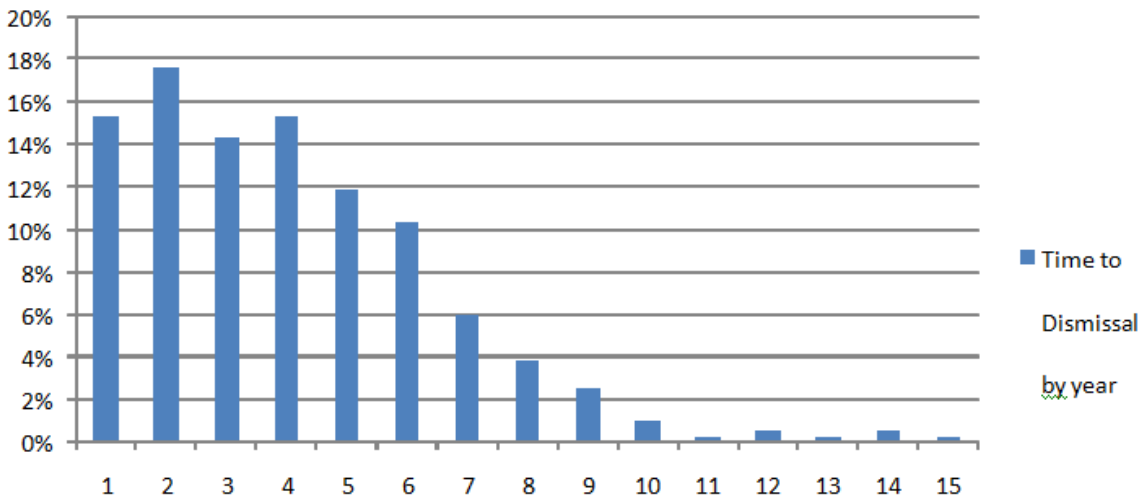


Table 6.1 illustrates descriptive statistics for the sample of 376 CEO-firm observations. The mean speed of response is 4.58 years.

Table 6.2 presents the Pearson correlation coefficients of the variables used in the hazard model that follows. Several features of the correlation matrix merit further discussion. The correlations show that many variables are related to speed of CEO dismissal as expected. Most corporate governance measures are significant and positively correlated with speed of CEO dismissal, indicating that firms with strong governance are likely to dismiss CEOs sooner under deteriorating firm performance situations. Of the attribution variables only the consistency variable shows a significant and positive correlation with faster dismissals. CEO tenure is highly correlated with speed of dismissal. This is not surprising as both reflect a time variable and the longer the CEO stays in office after a downgrade will also mean the longer the CEO tenure. Because of multicollinearity, this variable was taken out of the hazard analysis but I use other

variables that capture the effect of CEO tenure. Prior literature emphasizes that CEO tenure would mean greater power and weaker governance. I have various other measures of corporate governance which is positively correlated with CEO tenure in the model. For the performance variables, ROA change is not significant. Abnormal stock return is significant and positively correlated with speed of dismissal which suggests that higher performance leads to slower dismissals. Control variables of firm size or market-to-book ratios do not seem to have significant effects.

**Table 6.1 Descriptive Statistics**

	<b>Variable</b>	<b>Mean</b>	<b>Std.</b>	<b>Skew</b>	<b>Max</b>	<b>Med</b>	<b>Min</b>	<b>N</b>
1	Speed of Dismissal	4.58	2.55	1.05779533	15.46	4.213699	1.03	376
2	CEO Tenure	5.74	2.60	0.72625987	15.51	5.415068	1.42	376
3	CEO Ownership	0.02	0.02	3.03502694	0.15	0.012989	0.00	373
4	CEO Age	53.86	6.19	-0.9425555	62.50	55.5	35.50	143
5	CEO Origin	0.41	0.49	0.3757623	1.00	0.00	0.00	191
6	CEO Gender	0.98	0.15	-6.254127	1.00	1.00	0.00	376
7	Duality	0.72	0.37	-1.0133503	1.00	1.00	0.00	376
8	Board Independence	0.66	0.15	-0.673142	0.92	0.674908	0.11	376
9	Board Size	9.47	2.45	0.386296	17.67	9.267857	3.33	376
10	Recommendation Drop	-0.45	0.35	-1.5947984	-0.01	-0.37	-2.00	376
11	ROA Change	0.00	0.33	-2.1109712	0.99	0.01108	-1.71	376
12	Abnormal Return	7.27	141.07	2.40511796	735.00	-20.331	-211.21	376
13	Firm Size	9009.79	19996.93	3.65865626	116531.00	1585.275	70.35	376
14	Market to Book	3.68	4.32	4.79143269	33.85	2.48507	0.63	373
15	Distinctiveness	0.00	0.00	0.42219626	0.01	-0.00018	-0.01	376
16	Consistency	0.00	0.00	2.82051499	0.01	0.001032	0.00	376
17	Commonality	0.72	0.70	0.65168332	2.89	0.66623	-0.55	376

Table 6.2 Correlation Table

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1 Speed of Dismissal	1.00																
2 CEO Tenure	0.84 ***	1.00															
3 CEO Ownership	0.08	0.05	1.00														
4 CEO Age	-0.11	-0.10	-0.30 ***	1.00													
5 CEO Origin	-0.22 ***	-0.23 ***	-0.04	-0.13	1.00												
6 CEO Gender	-0.02	0.00	0.01	-0.01	-0.13 *	1.00											
7 Duality	0.14 ***	0.16 ***	-0.06	0.26 ***	-0.07	-0.01	1.00										
8 Board Independence	0.14 ***	0.16 ***	-0.14 ***	0.17 **	-0.03	-0.01	0.25 ***	1.00									
9 Board Size	-0.01	0.02	-0.33 ***	0.29 ***	0.15 **	0.04	0.25 ***	0.03	1.00								
10 Recommendation Drop	0.12 **	-0.02	-0.12 **	-0.06	0.13 *	-0.06	0.07	0.05	0.14 **	1.00							
11 ROA Change	0.06	0.11 **	0.04	0.13	0.05	0.03	0.02	-0.01	0.12 **	-0.01	1.00						
12 Abnormal Return	0.26 ***	0.25 ***	0.02	0.07	0.04	0.06	0.03	0.18 ***	-0.04	-0.03	0.15 **	1.00					
13 Firm Size	-0.01	0.03	-0.24 ***	0.11	0.03	0.01	0.17 ***	0.05	0.44 **	0.13 **	0.19	0.02	1.00				
14 Market to Book	-0.02	-0.01	-0.01	-0.09	-0.02	0.04	0.01	0.00	-0.07	0.13 **		0.07	0.15 **	1.00			
15 Distinctiveness	0.04	0.06	-0.02	0.15 *	0.04	0.01	0.04	0.03	-0.06	-0.08	-0.20 **	0.00	-0.08	0.00	1.00		
16 Consistency	-0.58 ***	-0.51 ***	0.03	0.04	0.03	-0.04	-0.11 **	-0.18 ***	-0.13 **	-0.10 *	-0.09 *	-0.13 **	-0.15 **	-0.04	0.08	1.00	
17 Commonality	-0.04	-0.02	0.10 **	-0.12	-0.08	-0.07	-0.11 **	-0.09 *	-0.23 **	-0.17 **	-0.20 **	-0.02	-0.24 **	-0.18 **	0.01	0.27 ***	1.00

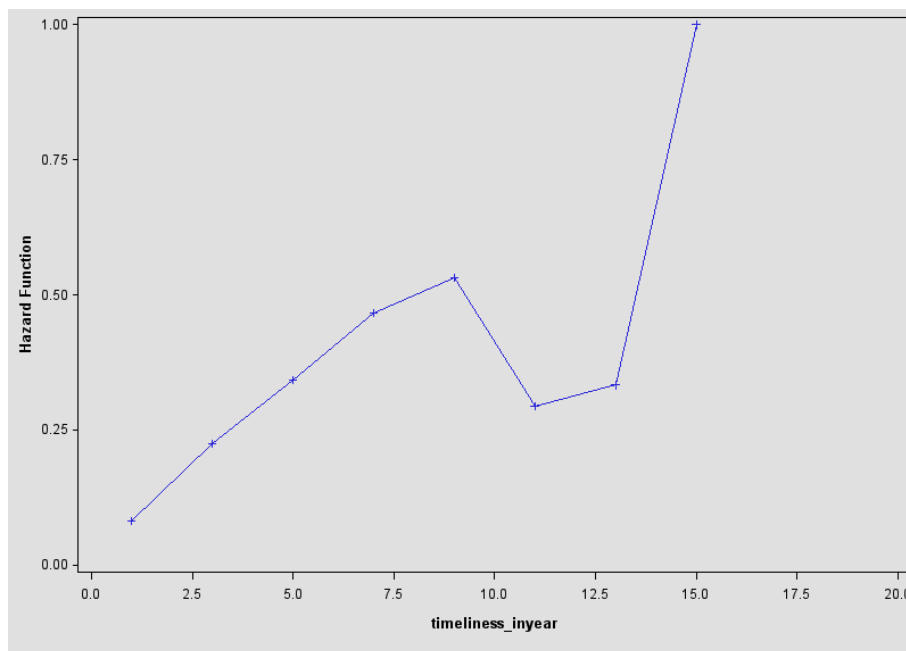
\*p&lt;0.1; \*\*p&lt;0.05; \*\*\*p&lt;0.00

## 6.2 Results of Antecedents of Speed of CEO Dismissal

The hazard model was employed to test three hypotheses of attribution variables: distinctiveness, consistency, and commonality. The dependent variable of the analysis is the log of time it takes to fire a CEO following the first analyst downgrade of the CEO's tenure.

I first examine the shape of the hazard function to see the relationship of risk of termination with speed of response. The Kaplan Meier product-limit method survival curve provides a useful summary of the data that can be used to estimate measures such as median survival time. Table 6.3 shows a figure of the hazard function of speed of dismissal using the Kaplan Meier Estimation (PROC LIFETEST in SAS). The graph shows that the hazard of CEO dismissal increases up to approximately 8 years after first downgrade and then goes down until 12 years and then goes back up. The last part where the hazard shoots up is likely to be irrelevant to the initial downgrade effects as to too lengthy a time after event.

**Figure 6.2 Base Hazard Rate of Speed of CEO Dismissal**



Next, I estimate an AFT model using the LIFEREG procedure in SAS. The first step is to choose the distribution that best characterizes the data to analyze the shape of the hazard function. Table 6.3 reports the results of the “fit statistics” and the likelihood ratio tests of exponential, Weibull, log-normal distributions against the alternative of the generalized gamma distribution. As the considered distributions are all nested in the generalized gamma distribution a likelihood ratio test can be used in addition to the Akaike information criterion (AIC) and the Bayesian information criterions (BIC) values. The Gamma and log-normal distributions have the smallest fit statistics which means a better fit. The Weibull and exponential distributions are rejected in favor of the generalized gamma; the p-values for the likelihood ratio test are 0.001. However, I cannot reject the hypothesis of the log-normal distribution ( $p=0.85$ ). Consequently, I report the results of the log-normal distribution in the following tests. Ocasio (1994) and Brookman & Thistle(2009) also use the log-normal distribution in their examination of CEO tenure. The results for the generalized gamma distribution are qualitatively the same as those for the log-normal distribution.

**Table 6.3 Statistics for distribution choice**

Null hypothesis	FitStatistics using attribution variables			Against generalized gamma distribution	
	AIC	BIC	Log Likelihood	Chi square	p-value
Gamma	369.562	393.139	-178.7809744		
Lognormal	368.349	387.996	-179.174253	0.7865572	<0.8542
Weibull	442.105	471.753	-221.0526	84.5432512	*** <0.001
Exponential	820.194	835.913	-406.09	454.6180512	*** <0.001

I next examine the effects of the covariates on speed of response to downgrade. The results for the duration model using the log-normal distribution are presented in Table 6.4. The analysis is done by stepwise addition of effects to show how the model behaves when corporate governance and CEO characteristics are included as covariates. The models are nested, allowing stepwise testing for improvement of fit. The first model shows the effect of the attribution variables on the time it takes to respond to downgrade. The second model added the magnitude

of recommendation downgrade and current firm performance. The third model introduces corporate governance variables. The fourth model includes CEO characteristics and firm size.

For all the attribution variables, the coefficients are significant and in the hypothesized direction in Model 1,2,3. The significance disappears for the distinctiveness and commonality variable most likely due to small sample size in the full model (sample size 79). This implies that the greater the negative magnitude of change in stock market return(distinctiveness) throughout the years after analyst downgrade the faster the dismissal, the greater the consistency the slower the dismissal, and the less common the firm/CEO performs in comparison to the industry leads to faster dismissals. Note that a negative coefficient implies faster dismissal (less time-to-CEO dismissal). However, depending on how the covariate is measured the predicted could be a positive or a negative. These results are quite interesting as they show that not only is current performance important in making the decision to fire but that the type of performance downturn has individual effects on the decision to fire as well.

Magnitude of analyst downgrades shows a significant coefficient showing that the magnitude of downgrade has an effect on speed of dismissal. Current firm performance measured in abnormal stock return (firm returns less market returns) shows that higher performance extends the time it takes to dismissal(slower dismissals). However, ROA does not have a significant effect.

For the corporate governance variables, CEO duality and board size show a significant coefficient in the hypothesized direction. If the CEO holds dual position this extends the CEOs time to dismissal suggesting that the CEOs power does have an effect on the decision to fire the CEO. Results show that the larger the boards size the faster the speed of dismissal. This is

interesting as large board size could be associated with longer decision making times. Results show the opposite.

When including the CEO characteristics covariates and firm size controls, the overall sample size significantly decreases (N=79) and does not show significance in any of the covariates other than abnormal return. The decrease in sample size is because the archival data did not have much information on CEO origin and age. However, all the covariates other than CEO origin have estimated coefficients in the predicted direction.

**Table 6.4 Hazard Models for Log-Normal Distribution**

Variables	Predicted	Model 1	Model 2	Model 3	Model 4
Distinctiveness	(+)	22.6266 ** (8.778)	25.0855 ** (8.792)	22.1368 ** (8.482)	-18.962 (29.729)
Consistency	(-)	-179.7 ** (8.554)	-174.74 *** (8.433)	-175.82 *** (8.403)	-236.33 *** (32.483)
Commonality	(+)	0.1169 ** (0.03)	0.1302 *** (0.03)	0.113 *** (0.03)	0.0852 (0.053)
Recommendation Drop	(+)		0.1471 ** (0.059)	0.1577 ** (0.058)	0.1018 (0.106)
Abnormal Return	(+)		0.0005 *** (0.000)	0.0005 *** (0.000)	0.0004 * (0.000)
ROA change	(+)		0.0375 (0.064)		
Duality	(+)			0.1394 ** (0.057)	0.1213 (0.113)
Board independence	(-)			-0.1248 (0.135)	0.1564 (0.273)
Board size	(-)			-0.0264 ** (0.009)	-0.0107 (0.026)
CEO Ownership	(+)				1.3274 (1.709)
CEO Age	(+)				0.0042 (0.007)
CEO Origin	(+)				-0.0809 (0.113)
Firm Size	(?)				0 (0.000)
Market to Book	(?)				0.0083 (0.012)
Likelihood value		-183.09	-174.03	-167.85	-24.566
N		376	376	376	79

\*p<0.1; \*\*p<0.05; \*\*\*p<0.001

Standard errors are in parentheses

### 6.3 Results of Consequences of Speed of CEO Dismissal

The hazard function shows that different types of performance have individual effects on the speed of CEO Dismissal. But, an important question I address next is does speed of CEO dismissal have an effect on firm performance after the change in CEO. This part of the analysis shows that speed of CEO dismissal, apart from current firm performance of strength of corporate governance, does affect post succession firm performance as hypothesized in chapter three.

As discussed in chapter five, I use the residual values from the model of determinants of speed of CEO dismissal. This allows to control for current firm performance, a major determinant in probability and speed of CEO dismissal. I conduct OLS regression of determinants of time as the first step and ultimately use the residuals from the regression models to create the measure of excess time. Excess time is the core construct defining speed of dismissal controlling for performance and governance effects. Ultimately, I obtain three alternative measures of excess time. Excess\_Time1 is defined as the length of time it takes to fire a CEO controlling for current firm performance (abnormal return). This is the residual obtained from Model 3 in Table 6.5 Excess\_Time 2 is defined as the length of time it takes to fire a CEO controlling for firm performance and strength of corporate governance. This is the residual obtained from the regression model 4.

Table 6.5 reports the results of an OLS regression analysis on the cross sectional data set of 397 observations. This data set is slightly larger than the one employed in the hazard model as there were fewer missing data when not obtaining the attributional variables. The dependent variable on the analysis is log of time-to-CEO-dismissal. Model 1 of the analysis shows that analyst downgrades do have an effect on the speed of CEO dismissal. The greater the magnitude of downgrades the faster the dismissal. Model 2 and Model 3 uses two different measures of current firm performance. ROA change and Abnormal stock return. As abnormal stock return is significant and shows that lower stock return leads to faster dismissal, I use the residuals from Model 3 as the first measures of excess time. These residuals, which I define as Excess\_Time1 is a measure of speed of dismissal controlling for current firm performance. In Model 4, governance controls are included in the OLS regression model. Other than board independence, showing a coefficient in the opposite hypothesized direction, none of the variables are

significant. It is interesting to find that the higher the independence, having more outsiders on the board, leads to slower dismissal (a positive coefficient). The residual from model 4 is the second measure of excess time. These residuals, which I define as *Excess\_Time2*, is a measure of speed of dismissal controlling for current firm performance and strength of corporate governance. Model 5 is the full model including firm performance, governance, CEO characteristics, and control variables. Other than abnormal return, none of the variables are significant. The residual from Model 5 is *Excess\_Time 3*. This could be because of the small sample size.

**Table 6.5 Determinants of Speed of CEO Dismissal**

Variables	Predicted	Model 1	Model 2	Model 3	Model 4	Model 5
Intercept		7.31 *** (0.045)	7.25 *** (0.029)	7.25 *** (0.028)		
Recommendation Drop	(+)	0.14 * (0.083)				
Abnormal Return	(+)			0.0008 *** (0.0002)	0.0007 *** (0.0003)	0.0006 *** (0.0003)
ROA change	(+)		0.10 (0.092)			
Duality	(+)				0.10 (0.141)	0.08 (0.148)
Board independence	(-)				0.34 * (0.194)	0.58 (0.33)
Board size	(?)				0.00 (0.000)	-0.05 (0.036)
CEO Ownership	(+)					0.72 (2.323)
CEO Age	(+)					0.00 (0.0004)
CEO Origin	(+)					-0.13 (0.149)
Firm Size	(?)					0.00 (0.000)
Market to Book	(?)					0.01 (0.011)
Number of Observations		397	397	397	383	83
Adj Rsquare		0.46%	0.05%	3.87%	3.35%	11.21%

\*p<0.1; \*\*p<0.05; \*\*\*p<0.001  
Standard errors are in parentheses

The next step of the analysis examines how the length of excess time relates with post succession firm performance. Each measure of excess time is categorized into three groups by

their relative magnitude: Slow, Moderate, Fast. The categorization is made simply by dividing the sample into three equivalent sizes. This is a relative measure of how speed affects post-succession performance controlling for current firm performance and other controls. I examine the speed of dismissal effects on the mean and median values of future stock returns and the change in ROA three years after the CEO end date. And, I calculate the mean and the median values of future stock returns and the change in ROA during three years after CEO end date. Panel A shows the mean values and panel B shows the median values.

Hypothesis 1 predicts that post-succession firm performance will have an inverted U relationship with speed of dismissal. This means that boards that fire the CEO in the moderate speed relative to other firms will outperform those in the slow or fast category. I use both mean (Panel A) and median values (Panel B) of post-succession firm performance.

Table 6.6 shows the relationship between post-succession firm performance and speed of CEO dismissal(three measures of excess\_time). In general the firms in the moderate group of speed of CEO dismissal seem to have the highest post-succession-performance among the three groups, which suggests an inverse U-shape relation between excess Timeliness and future performance. As shown for the measure Excess\_Time1, both stock based and accounting based measures show that the firms categorized as moderate speed has the best performance and the difference is significant. Using Excess\_Time2 which controls further for governance variances, firms categorized as moderate speed also outperform those in slow and fast for the ROA measure but stock based measures show that slow dismissals are better. Excess\_Time 3 further controlling for CEO characteristics does not give the hypothesized results and are insignificant. These results also suggest corporate governance affects the decision to fire the CEO in a timely manner as the

variation in post-succession firms becomes smaller for Excess\_Time2. Using Excess\_Time 3, the differences are smaller and insignificant probably due to the small number of observations.

Overall, this does give partial evidence that variation in speed of dismissal does affect post-succession firm performance. Results show that corporate boards may fire the CEO too early or too late following an analyst downgrade leading to lower post-succession performance.

**Table 6.6 Post -Sucession Firm Performance by Speed of CEO Dismissal**

**Panel A. Mean values of future stock returns and change in ROA**

Excess_Time1	N	Mean		Predicted Sign	Diff in Ab_Return Change	Diff in ROA Change
		Ab_Return Change	ROA Change			
Slow	132	-1.40%	0.60%			
Moderate	133	24.20%	8.40%	M - S (+)	25.56%**	7.73%*
High	132	5.90%	-1.50%	H - M (-)	-18.23%*	-9.90%

Excess_Time2	N	Mean		Predicted Sign	Diff in Ab_Return Change	Diff in ROA Change
		Ab_Return Change	ROA Change			
Slow	127	14.40%	0.01			
Moderate	128	10.90%	0.06	M - S (+)	-3.40%	5.40%
High	128	-0.10%	-0.01	H - M (-)	-11.10%	-6.80%

Excess_Time3	N	Mean		Predicted Sign	Diff in Ab_Return Change	Diff in ROA Change
		Ab_Return Change	ROA Change			
Slow	27	3.50%	-0.40%			
Moderate	28	-0.90%	-1.40%	M - S (+)	-4.40%	-1.00%
High	28	1.70%	3.40%	H - M (-)	2.50%	4.70%

\*p<0.1; \*\*p<0.05; \*\*\*p<0.001

**Panel B. Mean values of future stock returns and change in ROA**

Excess_Time1	N	Median		Predicted Sign	Diff in Ab_Return Change	Diff in ROA Change
		Ab_Return Change	ROA Change			
Slow	132	-16.60%	1.90%			
Moderate	133	2.90%	1.10%	M - S (+)	19.56%***	-0.80%
High	132	-4.60%	-0.60%	H - M (-)	-7.55%**	-1.66%*

Excess_Time2	N	Median		Predicted Sign	Diff in Ab_Return Change	Diff in ROA Change
		Ab_Return Change	ROA Change			
Slow	127	1.10%	0.70%			
Moderate	128	-7.80%	2.30%	M - S (+)	-8.90%	1.67%*
High	128	-8.40%	-0.30%	H - M (-)	-0.50%	-2.68%***

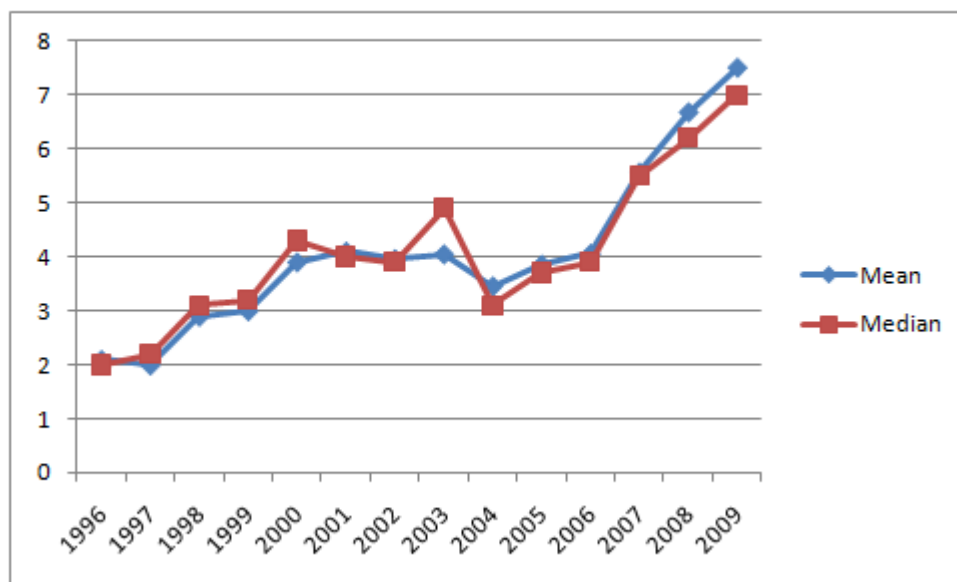
Excess_Time3	N	Median		Predicted Sign	Diff in Ab_Return Change	Diff in ROA Change
		Ab_Return Change	ROA Change			
Slow	27	-6.80%	-0.20%			
Moderate	28	-19.60%	-5.40%	M - S (+)	-12.80%	-5.20%
High	28	-8.40%	0.50%	H - M (-)	11.20%	5.90%

\*p<0.1; \*\*p<0.05; \*\*\*p<0.001

## 6.4 Results of Trend and Sarbanes-Oxley Effects on Speed of CEO Dismissal

Figure 6.3 shows the trend in “speed of CEO Dismissal” by fiscal year. Contrary to predictions, the trend seems to show a steady decrease in the speed of dismissal (becoming slower). Table 6.7 presents the number of dismissals, mean, and median of time-to-CEO-dismissal over the period 1996-2009. The mean time to CEO dismissal has increased by an average of 1.9 years after year 2002, the year of enactment of the Sarbanes-Oxley Act. A t-test comparing the means of sub-period difference is significant at the  $p < 0.01$  level. As the Sarbanes-Oxley act’s main objective is to give additional and more accurate information to the public, investment analysts might be downgrading the firm more frequently as can be seen from the increase in number of observations following year 2002.

**Figure 6.3. Speed of CEO Dismissal by Fiscal Year**



**Table 6.7 Trend in Speed of CEO Dismissal**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
N	14	18	14	24	20	15	26	28	38	40	31	37	31	40
Mean	2.1	2	2.9	3	3.9	4.1	4.0	4.1	3.5	3.9	4.1	5.6	6.7	7.5
Median	2	2.2	3.1	3.2	4.3	4	3.9	4.9	3.1	3.7	3.9	5.5	6.2	7
Mean by subperiod	3.0						4.9							
Median by subperiod	3.2						4.8							

The difference in time to CEO dismissal before and after Sarbanes-Oxley is tested by T-test and is significant at the 1% level.

To examine Hypothesis 6, I examine firm performance three years after CEO dismissal for the observations before and after the Sarbanes-Oxley period. Observations with fiscal years, that CEO end date falls within, prior to 2002 are classified as *Pre-SOX* and observations with fiscal years, which CEO end date falls within, after 2002 are considered post-SOX. *Ab\_Return\_3yrChange* is the value-weighted market adjusted return during three years starting one month after the CEO end date minus the average during the CEO tenure.  $\Delta ROA\_1yr$  is the net income one year after CEO end date minus the average net income during the CEO tenure scaled by the beginning assets.  $\Delta ROA\_2yr$  is the average net income during the two years after CEO end date minus the average net income during the CEO tenure scaled by the beginning assets.  $\Delta ROA\_3yr$  is the average net income during the three years after CEO end date minus the average net income during the CEO tenure scaled by the beginning assets.

Depending on whether I am using stock based vs. accounting based measures, the results are opposite. When using change in abnormal return as the measure, for the firms in which boards have fired the CEO after year 2002 seem to do significantly worse. Whereas, if using accounting based measures firms in which boards that have fired CEOs after year 2002 seem to perform better. I also included one year and two year post-succession firm performance differences for ROA and the results seem to hold.

Hypothesis 6a predicted that post-succession performance would improve after enactment of the Sarbanes-Oxley act whereas Hypothesis 6b predicted that post-succession firm

performance would worsen. Using stock based measures I find confirmation for hypothesis 6a whereas the accounting measures confirm hypothesis 6b. Why such discrepancies between the two measures arise is yet to be investigated. Overall results show that boards have become more tolerant of the CEO, giving CEOs more time to recover after a downgrade.

**Table 6.8 Post-Succession Firm Performance Before and After SOX**

<b>Mean</b>					
	<b>N</b>	<b>Ab_Return_3yr Change</b>	<b>ROA_1yr Change</b>	<b>ROA_2yr Change</b>	<b>ROA_3yr Change</b>
<b>Pre-SOX</b>	105	44.95%	-6.29%	-10.46%	-7.31%
<b>Post-SOX</b>	271	-3.64%	5.91%	9.44%	9.83%
<b>Difference</b>		-48.59%***	12.20%**	19.90%***	17.14%***

<b>Median</b>					
	<b>N</b>	<b>Ab_Return_3yr Change</b>	<b>ROA_1yr Change</b>	<b>ROA_2yr Change</b>	<b>ROA_3yr Change</b>
<b>Pre-SOX</b>	105	34.72%	0.57%	-0.20%	-0.20%
<b>Post-SOX</b>	271	-10.90%	2.09%	2.88%	2.88%
<b>Difference</b>		-45.62%***	1.51%**	3.08%***	3.08%***

The difference is tested by T-test and is significant at the 1% level.

## 6.5 Summary of Results

Overall the regression on antecedents shows strong support for my attributional variables. The magnitude of performance change, the volatility of performance, and the commonality of performance all have individual effects on speed of CEO dismissal. Results of all the hypotheses are summarized in the following table. Further discussion of these findings and an exploration of their interrelationships are provided in the final chapter.

**Table 6.9 Summary of Results**

Hypotheses	Results
H1: High distinctiveness in decline information following an analyst downgrade will have faster CEO dismissals	Supported
H2: High consistency in decline information following an analyst downgrade will have faster CEO dismissals	Supported
H3: High commonality in decline information following an analyst downgrade will have faster CEO dismissals	Supported
H4: Speed of CEO dismissal following an analyst downgrade will have an inverted U shape relationship with post-succession firm performance	Partial Support
H5: CEO dismissals occurring in the post-SOX period will have higher post-succession firm performance than CEO dismissals occurring in the pre-SOX period	Partial Support when using ROA as performance metric
H6: CEO dismissals occurring in the post-SOX period will have low post-succession firm performance than CEO dismissals occurring in the pre-SOX period	Partial Support when using Abnormal return as performance metric

## **CHAPTER SEVEN: DISCUSSION AND IMPLICATIONS**

This chapter contains three parts. First, a discussion of the research findings is presented. Second, implications of this study for theory and practice are discussed. Finally, the limitations of this study and suggestions for future research are provided.

### **7.1. Discussion of Research Findings**

This study set out to develop a model of speed of CEO dismissal by building on attribution theory. CEO dismissal is most likely a response by corporate boards of directors for the CEO not performing accordingly with the corporate boards' expectations. There has been extensive literature on CEO dismissals (see Finklenstein, et al 2008 for review), however, the majority of the literature has focused on corporate board composition and relative CEO power. These were based on economic and sociopolitical perspectives, rarely considering the influence of sense making and interpretation in the CEO dismissal process (Haleblian & Rajagopalan 2006). Although, Fredrickson et al, (1988), Schaffer (2002) and even more currently Haleblian & Rajagopalan(2006) emphasize that boards of directors' expectations, attributions, allegiances and values play a critical role in CEO dismissals, up to my knowledge these behavioral models have not been empirically tested. The difficulty is that the boards' interpretations cannot be explicitly measured but only theorized.

I also integrate and build on downturn and strategic change literature (Ford 1987; Cameron et al 1987; Barker et al 1997; and Barr & Huff 1977 ). Many of the downturn and

strategic change literature focused on top managements' response to performance downturn, however, boards of directors are also responsible for assessing the organization's top management during periods of poor firm performance (Forbes and Milliken 1999). As the corporate board's response and timeliness in response to performance downturn also has important implications for the firm, I identify the factors affecting the timing of strategic response at the corporate board level.

By examining the board's perception of performance, its attributions of different types of performance feedback after performance downturn and efficacy assessment of the CEO, I contribute to the CEO turnover literature by offering a behavioral and dynamic model that is empirically tested by developing measures of different types of informational cues of performance feedback. I go one step further to examine not only the probability of CEO dismissal but also examine the time it takes to dismissing the CEO following a performance downgrade. As the result, this study yields insight into both the CEO turnover literature and turnaround and strategic Change literature.

A two-stage research design employing both qualitative and quantitative data gathering was used in this study. The first stage employed qualitative case study to define and develop the constructs and model used in CEO dismissals. This initial phase helped to enrich the understanding of boards of directors' perception and interpretation process in evaluating the CEO. The second stage of the research used an archival dataset and provided tests of the relationship hypothesized in the model. The archival data was collected from a population of public U.S. firms between 1992-2009.

The following sections summarize and discuss the research findings presented in Chapter Six. First, integrating corporate governance theory with attribution theory and examining the

processes by which board members attribute poor firm performance, I find insight into how performance following a performance downturn impact the decision to dismiss the CEO in a timely matter. Second, whether corporate boards' speed of response affects future firm performance and whether boards are responding sub-optimally in their timeliness in response to downturn is identified. Third, I discuss how boards use the performance information following an analyst downgrade to assess the ability of a CEO. Finally, the insight into how the SOX legislation has affected corporate boards in their monitoring of the CEO is presented.

#### 7.1.1 Board assessments of managerial performance following performance downturn

Many firms enter periods of declining performance and firms frequently alter strategies and structures in response to environmental changes (Chandler, 1962). Kiesler and Sproull's (1982) seminal paper theorize that noticing and constructing meaning to internal or environmental feedback varies by the type of feedback and also disposition of the decision maker. Bar & Huff (1997) also provides evidence that there is diversity in the timing of strategic response to performance downturn. Ford (1985) further posits that response to performance downturn requires understanding decision makers' attributions of causality. Along these lines of reasoning, I empirically test how different types of performance following performance downturn, proxied by an analyst downgrade, affect board's perception and assessment of CEO performance.

First, I developed measures of informational characteristics of performance feedback that are identified in attribution literature: distinctiveness, consistency, and commonality. These performance measures are stock based measures, conceptualizing different types of organizational downturn. My analysis tested whether these different types of performance feedback each had individual effects on board's decision making of dismissing the CEO. Results

showed that the stronger the magnitude in performance drop, the more consistency (less volatility) in performance, and the lower the commonness in performance compared to the industry in the faster the boards dismissed the CEO.

These findings have important implications on strategy research. It demonstrates not all types of performance downturn are alike. Types of firm performance have different informational cues that board's use in their perception and attribution of causality. This lends support to arguments (Pietcher et al 2000, Puffer & Weintrop 1991) that different measures of prior performance lead to inconsistent findings and difference in percentage of variance explained in CEO research. Researchers studying organization downturn also posit that there is a need to operationally differentiate types of organizational downturn and delineate the effects. Cameron, Kim, & Whetton (1987) emphasized the need to precisely specify the conceptual domain of organizational downturn clarifying that turbulence, stagnation, and uncertainty are different constructs. This study also shows that the type of performance indicator or organizational downturn used by board has individual effects on the decision to dismiss a CEO.

There was also debate on whether corporate boards fire CEOs after bad firm performance caused by factors beyond CEO's control. Morck, Shleifer, and Vishny (1989) find that top management dismissals are equally likely to occur in troubled and in healthy industries, suggesting that CEO dismissal decisions are made regardless of industry shocks. However, Jenter & Kannan 2006 finds in a more recent dataset that CEOs are more likely to be dismissed from their jobs after bad industry and market performance. My results give evidence to the former in that corporate boards seem to filter some observable exogenous shocks when assessing CEOs quality.

#### 7.1.2 Effects of Speed of Response

Strategic change literature posits that some firms are able to adjust to changing circumstances while others fail to respond (Whetten 1980, D'Aveni 1989). A common theme in organization downturn literature also examines when organizations notice and adapt to deteriorating performance and make strategic changes for turnaround (Hambrick & Schecter 1983). The timeliness in response and adjustment was also seen as a critical factor for successful turnaround (Barr & Huff 1997, Witteloostuijn 1998). My results support these studies in the CEO dismissal phenomena that the speed of response by corporate board members also impact future firm performance.

Several studies suggest that responses are accurate and rationally made in a timely matter (Ertugrul & Krishnan 2008). Other studies suggest that because boards are bounded rational and interpretation can be biased and optimal response time may not always be the case (Dranikoff et al 2002; Golden & Zajac 2001). Results suggest that there is an optimal time in speed of response following performance downturn. Firms that have responded to downgrades by firing a CEO in a moderate speed compared to other firms that have responded at slower or faster speed performed better. Although this is a relative measure of speed of dismissal, this is evidence that too fast or too slow response time will lead to sub-optimal future firm performance. Such early dismissals might suggest that corporate boards may replace the CEO without having appropriately assessed the cause of downturn. Removing a CEO in such a way can adversely affect the value of a firm due to the lack of a consistent and stable leadership and replacement costs. The study also highlights that entrenched CEOs who should be fired hold on to their positions, which again raises issues to the board's fiduciary role.

### 7.1.3 Information of Analyst Downgrades

I used investment analyst downgrades as a proxy of the start of performance downturn. Prior literature finds that analyst downgrades affect the probability of CEO dismissal (Wierserma 2008). However, how the CEO responds to the analyst downgrade and whether a positive/negative response is rewarded/penalized by the board of directors has not been examined. Analyst downgrades are an uncertain signal and boards of directors will keep a closer eye on the CEO. My results find that performance following the downgrade which portrays how the CEO is responding to negative recommendations is an important metric in the assessment of CEO qualities. Stronger governance characterized by larger board size and no CEO duality also showed faster response times of firing the CEO following an analyst downgrade.

#### 7.1.4 Effects of Sarbanes-Oxley Legislation

This study examined the impact Sarbanes-Oxley has on speed of CEO dismissals and future firm performance. From open ended interviews, there were mixed responses by the interviewees who had served as board members in various firms. There was a view that SOX had absolutely no effect on board decision making and evaluation of the CEO. Another view said that there are processes that had to be put in place and because of these processes boards do find surprises in CEO quality. Rigor has increased after SOX has been put in place and there is a tendency to limit CEO tenure. My empirical results show that there is a significant effect of Sarbanes Oxley on corporate boards' decision to fire the CEO. Interestingly, opposite to my hypothesis that corporate boards will be faster with their dismissal due to increased shareholder activism I find that in fact corporate boards are increasingly becoming slower in their decisions to fire the CEO following an analyst downgrade. Because I do not control for any other reasons but only examine speed of CEO dismissal with a split sample of pre-SOX and post-SOX data, there can be several explanations for this.

Slower dismissals mean that boards are doing more due-diligence before replacing the CEO. It could be that after SOX, boards are being held more liable to their decisions and are being cautious with their decision to fire. Another reason that boards are taking more time to replace CEOs could be that there is a lack of available candidates. Given the increase in the number of dismissals (Booz Allen 2008) it could be the pool of applicants have dried up. Also, many CEO dismissals come from merger-related turnovers. As there have been decreases in mergers over time this may also give CEOs more time.

Such a trend has mixed implications on post-succession firm performance. Given, that the objective of the SOX legislation was to increase monitoring of the CEO and top managers by setting processes in place for better monitoring, it is likely that boards would make better decisions in replacing the CEO thereby having better future firm performance. However, examining the change in future firm performance and firm performance before CEO dismissal for firms in pre-SOX and post-SOX periods I find that firms are doing worse for firms that have fired CEOs in the post-SOX period when using stock based return measures. As I use abnormal returns which controls for market influences which is the difference between the expected return and actual return on an investment, it could be that investor's expected return could be erroneous have more uncertainty especially with market crashes in 2008. However, when using accounting based measures firms with CEO dismissals in the post-SOX period do significantly better than those in the pre-SOX period. This provides partial support to my hypothesis that better monitoring is in place.

## 7.2 Implications for Theory and Practice

This research contributes to theory and practice in several ways. Specific theoretical and practical contributions of this study are outlined in the following sections.

### 7.2.1 Attribution Theory

First, this study contributes to attribution theory by empirically testing the Kelley(1973) and Weiner (1974) covariation model of attribution in the CEO dismissal phenomena. While the use of attribution theory at the individual level has been thoroughly tested in psychology literature (Martinko 1998), how attribution arise at the group level and board of directors level has yet to be thoroughly tested. In strategy literature attribution theory has been used as an umbrella theory to explain causal reasoning of firm performance (Bettman & Weitz 1983; Mitchell et al 1981) or how managers strategically manipulate causal attribution to manage impressions (Meindl 1985; Hambrick et al 2008). In this particular study I integrate corporate governance literature with attribution theory to explain that political effects and cognitive effects have individual effects on the actions of boards of directors. This highlights that the CEO dismissal process has varying human aspects and is prone to errors in decision making. My research does *not* test whether boards misattribute the cause of downturn inappropriately to the CEO nor does it test the fundamental attribution error (Jones & Nisbett 1971). However, the results do hint that corporate boards are bounded rational and interpretation of performance feedback can lead to sub-optimal response time. Furthermore, my research highlights that there are costs to firing the CEO and replacing CEOs in response to short-term performance problems may in fact inadvertently penalize the firm.

Second, this study also contributes to attribution theory by developing measures frequently cited as different types of performance feedback. I incorporate Dess & Beard's(1984) measure of environmental volatility at the firm level to measure firm consistency. The

distinctiveness measure utilized data during the period for a more precise measure of magnitude of change rather than the more simple measure of taking the change at two time points. These types of performance measures can be used in testing almost any corporate strategy or business strategy decision making.

### 7.2.2 Corporate Governance and Board Decision Making

In clarifying the antecedents of speed of CEO dismissal, this research provides insights to practitioners regarding how boards should be careful in replacing the CEO and that the timing could have an effect on future firm performance. As suggested by this study, firms firing too early may not be giving CEOs ample time to recoup their faults and develop new strategies. This study also suggests that CEOs holding board chairman positions and larger boards are faster in their dismissals. This study also emphasizes again the problems of entrenched CEOs suggesting that older CEOs who have more power are not dismissed in a fast enough matter.

For investors, the study does show that firing the CEO may not necessarily lead to better stock returns. There are many papers on how the stock market reacts to CEO dismissals (Reinganum 1985; Zhang & Wiersema 2009) and the reactions were conditional upon a variety of factors including information investment analysts provide. I contribute to the literature on how information following an analyst downgrade provides information on CEO ability. How the CEO responds and recoups its losses is valuable information in the decision of boards on whether to retain or dismiss the CEO.

Finally, this study provides implications on how institutional regulations affect corporate governance. After SOX legislation was enacted in 2002, there have been several literatures examining the impact SOX has. Most have examined how the structure of board (Chhaorchharis & Grinstein 2007; Valenti 2008) and earning management (Jensen et al 2004; Koh et al 2010)

have changed. This study contributes by examining how CEO dismissals have changed. Results show that legislations do have an effect on board decision making which further affect firm performance.

### 7.3 Limitations and Directions for Future Research

Several limitations of this study should be noticed. Suggestions for future research that can address these limitations are also discussed in this section.

Firstly, there are several methodological limitations that should be mentioned. The study includes only public firms that have had an analyst downgrade. This poses a self selection problem(Heckman 1979) as firms that have analysts downgrades may be different from those that do not. Also, I am examining only large firms that have enough size and resources to have gone public. However, public firms account for only less than one half of one percent of all corporations (Aldrich 1999) and may lead to serious bias. My theory is based on firms that are in deteriorating performance conditions and should be different from those that do not have performance downturn. Future research should investigate other conditions that impact downgrade, by adapting a two stage model to identify and delineate factors that affect analyst downgrade but not CEO dismissal. Also, the methodology chosen for the hazard model was to use an accelerated failure time model. As mentioned in chapter four the model was chosen for various reasons but mostly because it gives an accurate prediction of survival time. However, this means that I cannot employ time varying covariates. As such, my measures use averages across time or select a meaningful time point. My main variables are non-time varying covariates and present no problems. Board characteristics may pose a problem as the structure of corporate boards can change over time. This is true, however, staggered boards is a prominent practice in US

corporate law meaning that there cannot be a sudden drastic change in board composition leading to minimal effects the change in board composition can have on speed of CEO dismissal.

Secondly, the effects of successor origin could have an effect on post-succession firm performance (Cannella & Lubatkin, 1993; Zajac, 1990). Prior literature examined the effects of inside versus outside successors (Dalton & Kesner, 1985; Friedman & Singh, 1989, Furtado & Karan, 1990; Walsh & Seward, 1990 Shen & Cannella, 2002b). Allgood and Farrel (2003) use a match theory to suggest that good matches are characterized by better firm performance. Depending on the reason of poor performance the choice of an outsider vs. an insider would vary. Hofer and Schendel (Hofer, 1978) classify type of turnaround approach as “strategic” or “operating” and posits that the need for CEO change and the need for inside or outside succession may differ. Given these research gaps, examining how attribution variables affect the selection and fit in successor will be a likely extension.

Finally, moderating effects were not accounted for in my model. Board characteristics and CEO power can affect the strength of the relationship of the attribution variables on speed of CEO dismissal. If the CEO has more power over the board, even if the board perceives and attributes the cause of downturn to the CEO, the boards may not be willing to dismiss the CEO. Other than CEO duality and board size, the direct effects were nonexistent. If no direct effect is present, tests of the moderator effect would have little meaning (James & Bret 1984). A larger sample and finer grained measure in future research can address this limitation.

## **Appendix 1 Interview Questions**

1. Please tell me a bit about your experience as a board member.
2. Are the functions of a board different when the firm is doing poorly vs. good?
  - a. Difference in when a company is doing well vs. not doing well?
  - b. Where do you get first signal not going well?
  - c. Can I speculate that those come as a surprise to the board?
3. How often is the CEO monitored and evaluated? Is there a time in a CEO's tenure in which s/he is more prone to being evaluated more attentively?

Going back to analyst downgrade ratings. Let's say it's a big corp. and you're downgraded by an analyst and no one else does so what?
4. How important is firm performance in evaluating the CEO? Specifically what aspects of performance do you consider?
5. In your experience at IBM and other firms, when would boards raise the issue of replacing a CEO? Can you walk us through the CEO replacement decision?
6. Do you know of any situations that have too quickly replaced or waited too long to replace a CEO? Do boards consider an optimal time in firing the CEO?
7. Are corporate boards sensitive to analyst rating information?
  - a. The driving question is.. the analyst downgrade. Is that ever a surprise to a board member?
  - b. Going back to analyst downgrade ratings. Let's say it's a big corp. and you're downgraded by an analyst and no one else does so what?
  - c. Do you think that's changed in recent years?
8. At IBM, you have experience hiring an insider and outsider. What was the difference and why did you make that decision?
9. In your view, has the legal system such as the Sarbanes Oxley act improved corporate governance? Was there any impact? Why or why not?

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