

# Changing of the Guards: Does Succession Planning Matter?

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# Succession Planning (SP)

- *2010 Survey* on CEO Succession Planning by *Heidrick & Struggles* and Stanford's *Rock Center for Corporate Governance*:
  - *Half of respondents* could not name a successor to current CEO.
  - *39% of respondents* had “zero” viable internal candidates.
  - Average board spends *only 2 hours per year* on succession planning.
- Even largest companies are taken by surprise when their CEOs leave unexpectedly:
  - *Bank of America, Hewlett Packard, Disney...*
- “*Companies forced into successions have lost about \$1.8bn per company more than if the successions had been planned.*”  
~FT, Strategy&

# SEC's Position

*“One of the **board’s key functions** is to provide succession planning [...]. Recent events have underscored the importance of this function to the governance of the corporation. [...] CEO succession planning raises a **significant policy issue** [...] that transcends the day-to-day business matter of managing the workforce.”*

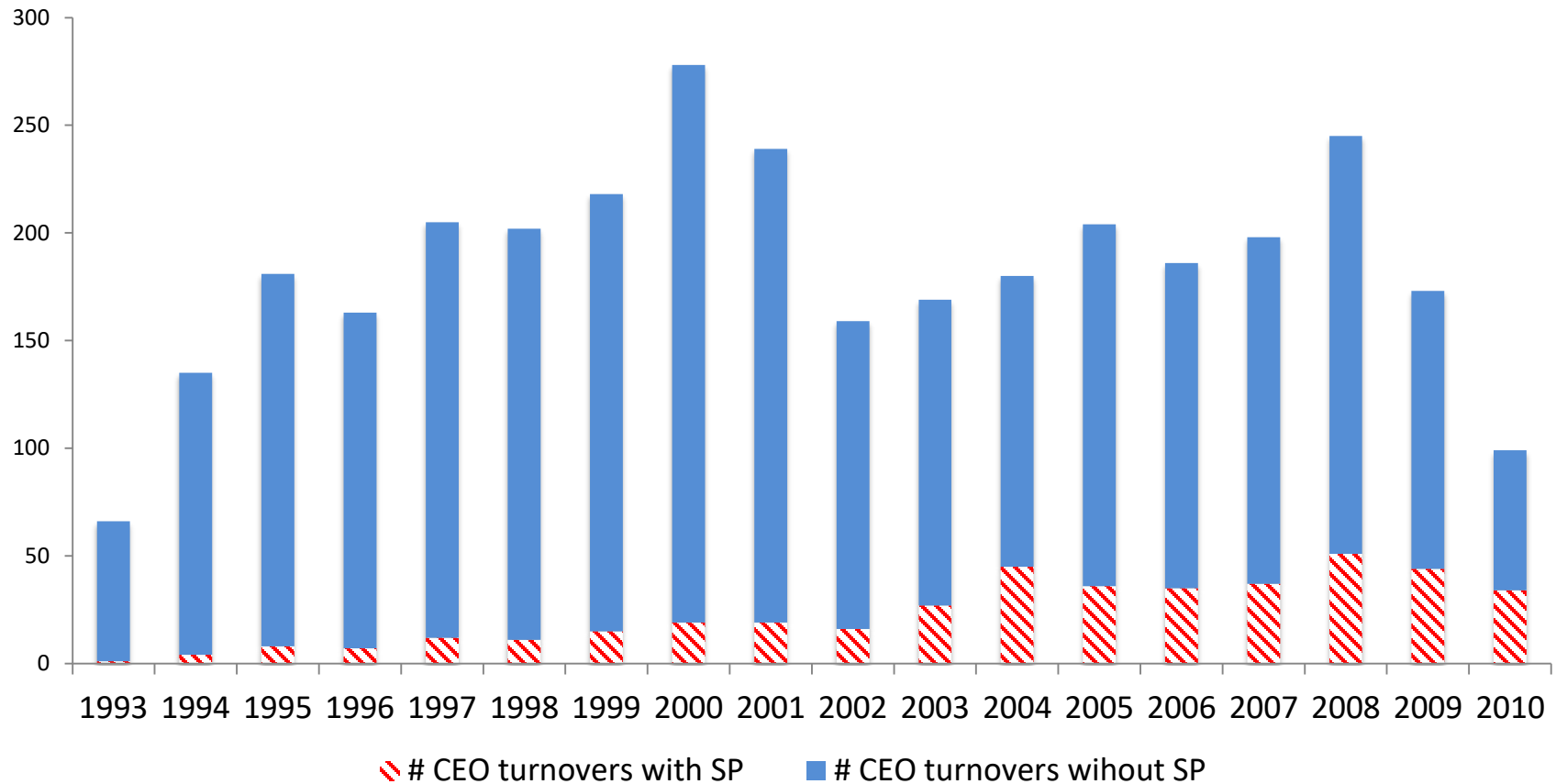
~ SEC Staff Bulletin No. 14E, October 27, 2009

- ① Guidance aimed at *increasing disclosure* about succession planning, including board’s leadership and role in risk oversight.
- ② Firms can no longer exclude *shareholder proposals* related to succession planning from their annual proxy statements.

# SP & CEO Turnover (1993-2010)

CEO Turnover Data: Dirk Jenter & Luke Taylor.

SP Data: Hand-collected from 8K reports and proxy statements.



# SP Data Example 1: Sysco Corp.

*“On an ongoing basis, the board plans for succession to the position of CEO and other key management positions, and the corporate governance and nominating committee oversees this management development and succession planning process. To assist the board, the CEO periodically provides the board with **an assessment of senior executives and their potential to succeed to the position of CEO**, as well as perspective on **potential candidates from outside the company**. In addition, the CEO periodically provides the board with an assessment of potential successors to other key positions.”*

~ Sysco Corp. DEF-14A /Oct. 8, 2009

# SP Data Example 2: Hershey Co.

*“The board shall review management succession plans **annually**. This shall include review of organization strength and management development and succession plans for **each member of the company’s executive team**. If the president, CEO, and/or chairman of the board is unable to perform for any reason, then: (1) if the company is without a chairman of the board, the vice chairman of the board, if any, shall serve as chairman until a replacement is elected, and in the absence of a vice chairman of the board, the chair of the governance committee or, the chair of the compensation and executive organization committee; (2) if the company is without a president and CEO, the interim president and CEO shall be the officer of the company; (3) in the case of incapacity of the president, CEO and/or chairman, the board shall determine whether to search for a replacement; and (4) the **chair of the compensation and executive organization committee shall lead any search for a replacement.**”*

~ Hershey Co. DEF-14A /Mar. 10, 2008

# Our Contribution

- We study the impact of formal succession planning on the

(1) *nature of management turnovers*

(2) *efficiency of turnover decisions*

in terms of:

- **turnover-performance sensitivity** (Weisbach, 1998; Huson, Parrino & Starks, 2001; Goyal & Park, 2002; Hillier, Fee & Hadlock, 2004; Linn & McColgan, 2005)
- **learning about CEO ability** (Taylor, 2010; Pan, Wang, Weisbach, 2015)
- **basing turnover decisions on firm-specific (vs. industry) factors** (Gibbons & Murphy, 1990; Barro & Barro, 1990; Jenter & Kanaan, 2015)

# Preview of findings

## Succession Planning

1. Ensures leadership continuity
  - ↑ voluntary and permanent successions
2. Is associated with lower firm uncertainty and faster learning about CEO ability
3. Improves efficiency of transitions
  - ↑ turnover-performance sensitivity
  - ↓ attribution of firing decision to factors beyond the CEO's control



# Literature

- Naveen (2006) studies a firm's propensity for a "relay succession", i.e., grooming of an internal candidate, as a function of its operational complexity, firm-specific human capital, and other firm attributes.
  - Defines a firm that has a president or a chief operating officer as a firm with a succession plan.
- Kale, Reis, and Venkateswaran, 2009; Kini and Williams, 2012 follow Naveen (2006)'s approach, but their focus is not on succession planning.
- Bennedsen, Nielsen, Perez-Gonzalez and Wolfenzon (2007) demonstrate that family successions are costly in terms of family firm operating performance and argue that professional CEOs provide valuable services to family firms.

# Data

- CEO turnover data: Lucian Taylor and Dirk Jenter
  - 3300 turnovers, including 900 forced ones
  - Turnovers due to mergers or spin-offs are excluded
- SP data: hand-collected
  - For each turnover, manually examine regulatory filings (8-K, DEF-14A) to identify whether the firm has a SP prior to the CEO turnover event
  - Create 3 indicator variables of (i) SP, (ii) SP discusses current CEO transition, and (iii) CEO remains during transition
- Stock return data: CRSP
- Firm data: Compustat
- CEO data: Execucomp
- Institutional ownership data: Thomson Reuters

# Summary statistics

Variables	SP firms		Non-SP firms		Difference in means	t-stat
	N	Mean	N	Mean		
CEO turnover sample						
SP	403	0.95	2436	0.00	0.95	
<b>Forced CEO succession</b>	<b>402</b>	<b>0.19</b>	<b>2432</b>	<b>0.28</b>	<b>-0.09***</b>	<b>-4.10</b>
<b>Insider successor</b>	<b>403</b>	<b>0.83</b>	<b>2436</b>	<b>0.79</b>	<b>0.04*</b>	<b>1.94</b>
<b>Interim successor</b>	<b>403</b>	<b>0.19</b>	<b>2436</b>	<b>0.29</b>	<b>-0.10***</b>	<b>-4.66</b>
CAR	392	0.04	2392	0.05	-0.01**	-2.51
CRSP-Compustat firm sample						
<b>Stock returns</b>	<b>391</b>	<b>-0.09</b>	<b>2308</b>	<b>-0.16</b>	<b>0.07**</b>	<b>2.43</b>
<b>ROA</b>	<b>403</b>	<b>0.04</b>	<b>2413</b>	<b>0.01</b>	<b>0.03***</b>	<b>5.04</b>
<b>Log(total assets)</b>	<b>403</b>	<b>8.21</b>	<b>2436</b>	<b>7.31</b>	<b>0.90***</b>	<b>9.39</b>
<b>Firm age</b>	<b>403</b>	<b>27.61</b>	<b>2436</b>	<b>22.24</b>	<b>5.37***</b>	<b>6.18</b>
Leverage	401	0.28	2402	0.25	0.03**	2.53
Dividend payer	403	0.68	2429	0.57	0.11***	4.31
Volatility of profitability (ROE)	403	0.56	2436	0.55	0.01***	6.20
ROE	403	0.09	2413	0.01	0.08***	3.66
<b>% institutional ownership</b>	<b>311</b>	<b>0.72</b>	<b>1741</b>	<b>0.65</b>	<b>0.07***</b>	<b>6.09</b>
<b># block owners</b>	<b>312</b>	<b>2.28</b>	<b>1742</b>	<b>2.15</b>	<b>0.13</b>	<b>1.27</b>
<b>CEO of retirement age</b>	<b>403</b>	<b>0.26</b>	<b>2436</b>	<b>0.15</b>	<b>0.11***</b>	<b>4.76</b>
<b>Log(CEO tenure)</b>	<b>403</b>	<b>1.88</b>	<b>2436</b>	<b>1.59</b>	<b>0.29***</b>	<b>10.15</b>

# SP & Leadership Stability

Succession planning ensures leadership continuity:



forced and



interim successions

OLS Estimation	Forced succession		Insider successor		Interim successor	
<b>SP</b>	<b>-0.0903***</b> <b>(-4.13)</b>	<b>-0.0772***</b> <b>(-3.88)</b>	<b>0.0601</b> <b>(1.44)</b>	<b>0.0652</b> <b>(1.53)</b>	<b>-0.0971***</b> <b>(-3.26)</b>	<b>-0.0864***</b> <b>(-3.14)</b>
Log(total assets)	-0.0228*** (-3.76)	-0.0180*** (-2.90)	-0.0039 (-0.57)	-0.0007 (-0.12)	-0.0286*** (-5.55)	-0.0199*** (-3.68)
ROA	-0.4886*** (-4.73)	-0.4429*** (-4.55)	0.1510*** (2.72)	0.1740*** (2.94)	-0.2238*** (-3.33)	-0.1877** (-2.23)
MTB	-0.0007 (-0.29)	-0.0061*** (-3.91)	0.0205*** (4.04)	0.0166*** (4.68)	0.0074 (1.47)	0.0030 (0.61)
SP discusses current CEO transition	-0.1251*** (-3.60)	-0.1209*** (-3.83)	0.0362 (0.97)	0.0400 (1.06)	-0.1036*** (-3.68)	-0.0948*** (-3.25)
CEO remains during transition	-0.2783*** (-7.55)	-0.2796*** (-7.39)	0.0525*** (3.47)	0.0534*** (3.53)	-0.0727*** (-4.11)	-0.0738*** (-4.24)
% institutional ownership	0.0312 (0.45)	0.0178 (0.30)	0.0183 (0.31)	0.0018 (0.03)	0.0618 (0.71)	0.0192 (0.27)
# block owners	0.0032 (0.72)	0.0050 (1.25)	-0.0057 (-1.16)	-0.0041 (-0.86)	0.0052 (0.52)	0.0077 (0.77)
Industry FE	No	Yes	No	Yes	No	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,975	1,975	1,978	1,978	1,978	1,978
Adjusted R <sup>2</sup>	0.186	0.198	0.0210	0.0240	0.0360	0.0454

# Endogenous SP

- Concern:
  - There may be firm- or industry-specific characteristics driving our results.
- Solution:
  - IV based on the recent work in the IO literature (Hoberg and Phillips, 2010, 2016).
  - Use similarity between a firm's products and those of its rivals to infer similarity in the human capital of the two firms' CEOs.
  - The closer the competition between two firms in the product space, the more similar the skills required of their CEOs.
  - Instrument (firm-level) SP using the percentage of the 20 *most closely related* firms having an SP.

# Endogenous SP (2)

- **Closely related firms:** use a version of text-based network industry classifications (TNIC) calibrated as granular as three-digit SIC codes by Hoberg and Phillips (2010, 2016):
  - TNIC classifications are based on firm pairwise similarity scores from text analysis of firm 10-K product descriptions.
  - Product descriptions must be accurate: Item 101 of Regulation S-K.
  - 10-Ks are updated on annual basis, the network of similarity scores is time-varying.
- The higher the fraction of firms among its 20 closest rivals has a disclosed succession plan, the more likely the firm is to generate a succession plan as well.
  - It is **time-varying** → alleviates the concern of a time-invariant firm-specific variable (e.g., governance or management entrenchment) driving our results.
  - TNIC industry definitions are **intransitive**, i.e., each firm has its own distinct competitors. In contrast to SIC industry definitions → alleviates the concern that firms in the same (transitive) industry may follow similar turnover practices in response to common industry shocks.

# SP & Leadership Stability (IV)

Succession planning ensures leadership continuity:

↓ forced and

↓ interim successions

IV estimates	First stage	Forced succession	Insider successor	Interim successor
% rival firms with SP	0.0168*** (4.86)			
SP-I		-1.8422** (-2.31)	-1.0565 (-1.02)	-1.3662** (-2.00)
Log(total assets)	0.0203** (3.19)	0.0175 (0.88)	0.0238 (1.07)	0.0002 (0.02)
ROA	0.0058 (0.11)	-0.4937*** (-3.76)	0.1115** (2.23)	-0.1873* (-1.75)
MTB	0.0006 (0.22)	-0.0020 (-0.34)	0.0200*** (3.07)	0.0071* (1.91)
SP discusses current CEO transition	-0.7337*** (-17.40)	-1.4092** (-2.31)	-0.7733 (-1.06)	-1.0234** (-2.09)
CEO remains during transition	0.0658*** (5.92)	-0.1728*** (-3.20)	0.1321* (1.81)	-0.0003 (-0.01)
% institutional ownership	-0.0203 (-0.39)	0.0011 (0.01)	0.0189 (0.26)	0.0251 (0.30)
# block owners	0.0047 (0.69)	0.0075 (0.76)	-0.0000 (-0.01)	0.0102 (1.35)
Year FE	Yes	Yes	Yes	Yes
Observations	1,799	1,796	1,799	1,799
R <sup>2</sup>	0.367	-1.162	-0.455	-0.669
Shea's partial R <sup>2</sup>	0.0023			
First-stage F-statistic (p-value)	23.61 (0.0009)			

# SP & Performance Metrics

- New *CD&A disclosures*, effective December 15, 2006:
  - Detailed **performance metrics/targets** for executive cash & equity compensation
  - Lower investor uncertainty about compensation incentives & reporting objectives (Ferri, Zheng & Zou, 2017)
- Goal of new disclosures – *Improve quality and precision* of performance measurement for evaluating management.
- ***Do firms with SP benefit as much as firms without SP?***



# SP & Performance Metrics (cont'd)

Dependent variable = CEO succession								
	SP-I firms	Non-SP-I firms	SP-I firms	Non-SP-I firms	SP-I firms	Non-SP-I firms	SP-I firms	Non-SP-I firms
	Performance = Stock return				Performance = ΔROA			
Performance adjusted by	Market performance		Industry performance		Market performance		Industry performance	
Post	0.0328 (1.01)	0.0056 (0.17)	0.0316 (0.97)	0.0042 (0.13)	0.0301 (0.92)	0.0016 (0.05)	0.0307 (0.94)	0.0015 (0.04)
Performance	-0.0299** (-1.98)	-0.0123 (-1.49)	-0.0321** (-2.05)	-0.0141* (-1.65)	-0.2206** (-2.19)	-0.0459 (-1.17)	-0.2104** (-2.36)	-0.0389 (-1.01)
<b>Post x Performance</b>	<b>0.0039</b> <b>(0.18)</b>	<b>-0.0473***</b> <b>(-3.33)</b>	<b>0.0098</b> <b>(0.43)</b>	<b>-0.0476***</b> <b>(-3.36)</b>	<b>0.1970</b> <b>(1.51)</b>	<b>-0.1518**</b> <b>(-2.16)</b>	<b>0.1872</b> <b>(1.48)</b>	<b>-0.1662**</b> <b>(-2.36)</b>
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,338	5,511	4,338	5,511	4,284	5,438	4,284	5,438
Within R <sup>2</sup>	0.123	0.102	0.122	0.102	0.123	0.103	0.123	0.103

# Abnormal returns and volatility

- Firms with SP experience lower ST volatility surrounding CEO successions

	All successions	Voluntary successions	Forced successions	All successions	Voluntary successions	Forced successions
	CAR			Log of CAR squared		
<b>SP-I</b>	<b>0.1040</b>	<b>-0.0093</b>	<b>2.4191</b>	<b>-0.0633***</b>	<b>-0.0833***</b>	<b>1.0537</b>
	<b>(1.16)</b>	<b>(-0.09)</b>	<b>(0.44)</b>	<b>(-2.98)</b>	<b>(-5.50)</b>	<b>(0.30)</b>
Log(total assets)	-0.0026	-0.0017	-0.0246	0.0014*	0.0022**	-0.0139
	(-0.80)	(-0.42)	(-0.31)	(1.84)	(2.34)	(-0.29)
ROA	-0.0302*	0.0019	-0.1151	-0.0168**	-0.0205	-0.0336
	(-1.65)	(0.07)	(-1.38)	(-2.13)	(-1.40)	(-0.64)
MTB	-0.0008	-0.0012	-0.0124	0.0002	0.0003	-0.0051
	(-1.30)	(-1.02)	(-0.46)	(0.97)	(1.45)	(-0.31)
SP discusses current CEO transition	0.0765	-0.0110	2.3069	-0.0494***	-0.0559***	0.9926
	(1.19)	(-0.15)	(0.44)	(-2.83)	(-4.78)	(0.30)
CEO remains during transition	0.0080	0.0087	-0.1044	0.0013	0.0022	-0.0610
	(0.88)	(1.25)	(-0.32)	(0.53)	(1.07)	(-0.29)
% institutional ownership	0.0006	0.0062	-0.0819	-0.0081**	-0.0121***	-0.0306
	(0.05)	(0.51)	(-0.39)	(-2.29)	(-4.08)	(-0.23)
# block owners	-0.0020	-0.0010	-0.0002	0.0004	0.0010*	0.0004
	(-1.32)	(-0.66)	(-0.02)	(1.01)	(1.73)	(0.06)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,768	1,317	448	1,768	1,317	448

# Long-term uncertainty

- Firms with SP experience lower LT volatility surrounding CEO successions
  - Clayton, Hartzell, and Rosenberg (2005)

	All successions	Voluntary successions	Forced successions		All successions	Voluntary successions	Forced successions
	Realized return volatility				Idiosyncratic return volatility		
<b>SP-I</b>	<b>-2.3955***</b>	<b>-1.7150***</b>	<b>-29.7381</b>		<b>-2.0286***</b>	<b>-1.4423***</b>	<b>-16.9928</b>
	<b>(-3.86)</b>	<b>(-4.39)</b>	<b>(-0.22)</b>		<b>(-4.44)</b>	<b>(-3.18)</b>	<b>(-0.34)</b>
Market beta	0.1882***	0.1847***	0.0217				
	(4.26)	(4.20)	(0.03)				
SMB beta	0.0549	0.0646*	-0.0278				
	(1.04)	(1.86)	(-0.08)				
HML beta	0.0115	0.0024	0.0785				
	(0.43)	(0.11)	(0.19)				
Controls	Yes	Yes	Yes		Yes	Yes	Yes
Year FE	Yes	Yes	Yes		Yes	Yes	Yes
Observations	1,766	1,315	448		1,769	1,317	449

# SP & Learning about CEO Ability

	Realized return volatility			Idiosyncratic return volatility		
	All firms	Non-SP-I firms	SP-I firms	All firms	Non-SP-I firms	SP-I firms
CEO tenure (year 1)	-1.3007*** (-6.82)	-1.4958*** (-5.39)	-0.5708** (-2.30)	-1.4299*** (-7.34)	-1.6142*** (-5.72)	-0.6171** (-2.42)
CEO tenure (year 2)	-0.2834** (-1.96)	-0.3123* (-1.65)	0.3140 (1.39)	-0.3918*** (-2.68)	-0.3881** (-2.00)	0.2945 (1.23)
CEO tenure (year 3)	-0.4027*** (-3.08)	-0.4594*** (-2.74)	0.1452 (0.65)	-0.4960*** (-3.67)	-0.5029*** (-2.98)	0.0956 (0.42)
Firm-CEO FE	Yes	Yes	Yes	Yes	Yes	Yes
Calendar year-month FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	49,839	28,760	21,079	49,850	28,760	21,090
Within R <sup>2</sup>	0.377	0.361	0.421	0.353	0.340	0.388

CEO tenure	-1.5447*** (-5.56)	-1.7772*** (-4.43)	-0.7834** (-2.12)	-1.7038*** (-6.34)	-1.9636*** (-5.06)	-0.8803** (-2.42)
CEO tenure <sup>2</sup>	0.4897*** (2.65)	0.5714** (2.22)	0.4312 (1.64)	0.4848*** (2.67)	0.6006** (2.38)	0.3762 (1.44)
CEO tenure <sup>3</sup>	-0.0663 (-1.55)	-0.0784 (-1.35)	-0.0627 (-0.98)	-0.0610 (-1.44)	-0.0774 (-1.36)	-0.0481 (-0.75)
Firm-CEO FE	Yes	Yes	Yes	Yes	Yes	Yes
Calendar year-month FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	49,839	28,760	21,079	49,837	28,759	21,078
Within R <sup>2</sup>	0.377	0.360	0.421	0.253	0.245	0.278

# SP & Firm-specific vs. Industry Factors

	Dependent variable = Forced CEO succession					
	Industry return - EW			Industry return - VW		
	All firms	Non-SP-I firms	SP-I firms	All firms	Non-SP-I firms	SP-I firms
Idiosyncratic return $t_{-1}$	-0.1412*** (-8.26)	-0.1249*** (-5.44)	<b>-0.1528***</b> <b>(-5.26)</b>	-0.1386*** (-8.13)	-0.1236*** (-5.38)	<b>-0.1468***</b> <b>(-5.16)</b>
Industry-induced return $t_{-1}$	-0.0974** (-1.97)	-0.1520** (-2.32)	<b>-0.0521</b> <b>(-0.61)</b>	-0.1294*** (-2.64)	-0.1825*** (-2.76)	<b>-0.1017</b> <b>(-1.24)</b>
Idiosyncratic return $t_{-2}$	-0.0579*** (-3.43)	-0.0649*** (-3.07)	<b>-0.0976***</b> <b>(-3.03)</b>	-0.0573*** (-3.40)	-0.0626*** (-2.97)	<b>-0.1009***</b> <b>(-3.10)</b>
Industry-induced return $t_{-2}$	-0.0009 (-0.02)	0.0109 (0.15)	<b>-0.0650</b> <b>(-0.77)</b>	-0.0091 (-0.18)	-0.0268 (-0.39)	<b>-0.0330</b> <b>(-0.40)</b>
CEO of retirement age	-0.2073*** (-15.95)	-0.2521*** (-12.29)	-0.1790*** (-8.38)	-0.2070*** (-15.96)	-0.2520*** (-12.34)	-0.1785*** (-8.37)
CEO tenure	-0.0248*** (-9.53)	-0.0238*** (-6.55)	-0.0238*** (-5.86)	-0.0247*** (-9.47)	-0.0235*** (-6.45)	-0.0238*** (-5.83)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,037	1,462	1,170	3,033	1,460	1,168
Pseudo R <sup>2</sup>	0.138	0.134	0.131	0.137	0.132	0.130

# SP & Firm-specific vs. Industry Factors

- First stage regressions

	Firm return $t-1$	Firm return $t-1$	Firm return $t-2$	Firm return $t-2$
EW industry return $t-1$	0.6759*** (24.32)			
VW industry return $t-1$		0.7577*** (22.96)		
EW industry return $t-2$			0.7019*** (24.81)	
VW industry return $t-2$				0.7700*** (22.08)
Observations	47,733	47,653	46,576	46,482
Adjusted R <sup>2</sup>	0.144	0.127	0.142	0.130

# Conclusion

- Large-scale evidence on the role of formal SP on the nature and efficiency of turnover decisions:
  - **Leadership continuity** – fewer forced turnovers and less likely short term solutions
  - Marginal adjustment in **turnover-performance sensitivity** following the 2006 CD&A disclosure change
  - Less **learning about CEO ability** post-turnover
  - Less **reliance on peer (industry) performance** in turnover decisions