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or Valuable Resources?**

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Dice Center WP 2007-4
Fisher College of Business WP 2007-03-007

September 2008

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Former CEO Directors: Lingering CEOs or Valuable Resources?

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This draft: September 2008

Abstract

A firm is more likely to reappoint a former CEO to its board of directors after retirement the better is the firm's market-adjusted stock performance, the longer is the CEO's tenure, if the CEO is a founder of the firm, and the more inexperienced is the successor CEO. Firms with former CEO directors make different corporate decisions. The relative performance-turnover sensitivity of the successor CEO is higher when the former CEO is a director. There is some evidence of more continuity of corporate policies and better performance when former CEOs are directors. After extremely poor firm performance under their successors, former CEOs often return to the CEO position. When they do so, their firms do as well as industry and past performance matched firms.

Keywords: CEO turnover, rehired CEO, former CEO, relative performance evaluation

JEL Classification: G14, G34

*The Ohio State University. **Santa Clara University. We thank participants at the American Finance Association 2008 Chicago meetings, and seminar participants at the University of Cologne, HEC Lausanne, Ohio State University, and Santa Clara University for helpful comments and discussions. We appreciate the comments of Andres Almazan, Jay Barney, Peter Bossaerts, Phil Davies, Bernard Dumas, Dirk Jenter, Steve Kaplan, Andrew Karolyi, Alexander Kempf, Stew Myers, Stefan Ruenzi, René Stulz, Jérôme Taillard, and Mike Weisbach. We thank Robert Prilmeier and Peter Wong for excellent research assistance. The authors acknowledge financial support from the Charles A. Dice Center for Research in Financial Economics. Address correspondence to Rüdiger Fahlenbrach, Fisher College of Business, The Ohio State University, 812 Fisher Hall, Columbus, OH 43210, rudi@cob.osu.edu.

1. Introduction

Should firms reappoint their former CEOs to the board of directors after their retirement? The board of directors (BOD) is an essential element of corporate governance, acting as a link between shareholders and senior management. The former CEO of a firm could be a valuable addition to the board because he is arguably the director with the most firm-specific knowledge and could help mentor his successor to guarantee a smooth transition. Also, because of his firm-specific knowledge he could help effectively evaluate his successor assisting the board disentangle the effects of pure luck and skill. Furthermore, unlike most inside directors who also have firm-specific knowledge, the former CEO does not depend on the current CEO. Yet, institutional investors and their proxy advisors, as well as other board members, are opposed to the reappointment of the former CEO to the board of directors, suggesting negative effects of the board membership of these individuals.¹ A potential cost of former CEOs as board members is that the former CEO protects his often hand-picked successor. Another pitfall of retaining a former CEO as a board member is that a clean transfer of power may not take place. For example, the former CEO may be more reluctant to accept changes in corporate policies and strategies proposed by his successor or he may undermine the authority of a new CEO. Rumors of such power struggles between new and former CEOs in the board room have been reported in the popular press for, e.g., Citigroup, Xerox, Dow Chemical, or Newell Rubbermaid.

We examine the determinants of reappointing a former CEO to the board after retirement and corporate decisions after the reappointment using a sample of about 2,100 turnovers at publicly traded US firms for the period from 1994 to 2004.

¹ For example, proxy voting advisor Institutional Shareholder Services, a division of RiskMetrics Group, publishes a Corporate Governance Quotient, an aggregate measure of governance quality. One of the criteria that negatively influences a firm's quotient is the board membership of a former CEO. Also, a survey of 1,000 directors conducted by the magazine *Corporate Board Member* in conjunction with *Price Waterhouse Coopers* in 2003 found that only 25.3% of survey respondents said that it was a good idea to have the former CEO on the board.

We find that the tenure of the former CEO, the stock market performance, and the founder status of the former CEO are strong predictors of a former CEO's own board membership one year or two years after his retirement. These findings are consistent with Brickley, Linck and Coles (1999) who analyze whether a CEO's current performance predicts directorships post-retirement, both at the CEO's own firm and other firms. In addition, we document that the relative inexperience of the successor CEO, measured by his age, and whether or not the successor is an internal appointment also matter for the decision to reappoint the former CEO to the board. These latter results are consistent with the succession planning described by Vancil (1987) and tested by Naveen (2006) in which a firm promotes from within and retains the former CEO as chairman of the board during the early stages of the new CEO's tenure.

Having documented the determinants of a former CEO being reappointed to the BOD, we then analyze whether firms which reappoint the former CEO to the board make different corporate decisions than firms that do not reappoint the former CEO. First, we estimate whether the presence of the former CEO on the board has an impact on the relative performance evaluation of his successor. A former CEO may be able to recognize sooner than other board members that his successor lacks ability and encourage a new executive search. On the other hand, a former CEO may convince a board to give the current CEO more time to improve performance because he is partial to an internal candidate whom he has groomed. We find that firms with former CEOs as directors are better at relative performance evaluation than firms without former CEOs as directors. CEOs are more likely to lose their job after poor idiosyncratic firm performance when a former CEO sits on the board of directors.

Second, we examine changes in corporate policies and firm performance around the reappointment of the former CEO to the BOD. If the firm is expected to continue with its existing strategy and corporate policies, the former CEO may be particularly valuable as a mentor to the new CEO. On the other hand, a new CEO may not be able to implement the necessary changes in corporate policies to improve or maintain performance if his suggestions are blocked or undermined in board meetings by the former CEO who does not want his legacy undone.² We find no evidence of detrimental effects of former CEOs sitting on the board of directors. While there is some evidence that financial policies, property, plant, and equipment, and sales, general, and administrative expenses change less when a former CEO remains board member, we do not find evidence of deteriorating performance in these firms. In fact, using a past-performance, size, and industry-adjusted control sample, as suggested by Barber and Lyon (1996), we find that firms with former CEOs on board perform better than similar firms without former CEOs on board.

Third, we focus on an extreme situation in which having a former CEO on board may be particularly valuable (e.g., Vancil (1987)). We analyze the decision by the board of directors to rehire a former CEO director as CEO. While several recent rehiring decisions have triggered considerable media interest (e.g., Michael Dell, Charles Schwab, Howard Schultz at Starbucks, and Paul Allaire at Xerox),³ very little is known about how often and under what circumstances such an event happens. If the labor market for CEOs is characterized by scarcity of supply, it may be valuable to reappoint a former executive to the board of directors to have a potential

² Guembel and Casamatta (2006) show theoretically how such legacy considerations of a CEO interact with strategy changes and CEO turnover.

³ e.g., Anonymous (2001), Darlin and Lohr (2007), Lublin and White (2007), Jones (2006), and Olian (2003).

CEO candidate available.⁴ We find that rehiring a former CEO is not an uncommon event for poorly performing firms. Approximately 60 of our sample firms rehire their former CEOs. The typical rehired CEO comes back after two years in retirement and after the firm has lost 50% of its market capitalization under the current CEO. The rehired CEO is 61 years old at the time of his rehiring, and stays on as CEO for another two and a half years. Carefully controlling for sample selection issues, we find that a firm is more likely to rehire the former CEO if the former CEO is the chairman of the board, if the former CEO has not been in retirement for too long, and if the firm experiences particularly poor performance under the current CEO. One interpretation of this result that is consistent with Vancil (1987) is that it is especially valuable to retain a former CEO for a short time because he is willing to come out of retirement to run the firm again after a sudden negative shock to firm performance. Furthermore, we document that the rehired CEO performs as well as a CEO of a different firm from the same industry with similar past performance.

Our results extend the literature in a number of ways. First, we add to the recent empirical literature on the role of inside directors (e.g., Masulis and Mobbs (2008) and Coles et al (2008)) and the structure of the board of directors (e.g., Raheja (2005), Adams and Ferreira (2007), Linck, Netter and Yang (2008), and Boone, Field, Karpoff and Raheja (2006)). In general, these papers have argued that firms structure their boards according to their monitoring and advising needs. Our results suggest that firms with inexperienced successor CEOs will benefit from successful former CEOs on the board who are able to mentor and evaluate more effectively their successors. Second, we contribute to the literature on relative performance evaluation and turnover (e.g., Warner, Watts, and Wruck (1988), Parrino and Starks (2001),

⁴ Several recent papers suggest a limited supply of strong CEO candidates (e.g., Himmelberg and Hubbard (2000), Gabaix and Landier (2008) and Rajgopal, Shevlin and Zamora (2006))

Jenter and Kanaan (2008), and Kaplan and Minton (2008)). Our result suggests that former CEOs help the board overcome the difficulties in evaluating CEO performance, because firms with former CEOs as board members have quicker turnovers when idiosyncratic firm performance is poor. Finally, we add to the literature on succession planning (e.g., Naveen (2006), and Vancil (1987)).

The remainder of the paper is organized as follows. Section 2 develops hypotheses about the decision to reappoint the former CEO to the board of directors and hypotheses about corporate decisions after the reappointment. Section 3 describes the sample. The empirical results are discussed in Section 4. Section 5 concludes.

2. Relevant Literature and Testable Hypotheses

In this section, we discuss the determinants of the decision to reappoint the former CEO to the board of directors and relate them to prior literature. We then develop hypotheses about corporate decisions after the reappointment of the former CEO to the board.

2.1. Determinants of the reappointment decision

Brickley, Linck, and Coles (1999) argue that managers will have career concerns even in the final years of employment as long as managers care about post-retirement opportunities and that these opportunities are positively correlated with the manager's performance during the final years of his tenure. They test this hypothesis during the 1989 to 1993 period by examining the likelihood that a retiring CEO serves on his own board and other boards after retirement. They find that the likelihood of a CEO remaining on his own board two years after retirement is

positively related to his firm's stock performance while CEO. Given this result, we control for a firm's stock performance during the former CEO's tenure in our empirical tests examining the likelihood that a CEO is reappointed to the board after retirement.

The costs of transferring firm-specific knowledge are important considerations in the process of CEO turnover (see, e.g., Vancil (1987) and Naveen (2006)). We expect that the likelihood of reappointing the former CEO as a board member will be higher in firms with more firm-specific capital. We measure firm-specific capital using the ratio of research and development (R&D) expenditures to sales, the ratio of net property, plant and equipment (PPE) to total assets, and a high-tech industry indicator variable following Loughran and Ritter (2004). We also include firm size, measured by the natural logarithm of total assets as an additional proxy for firm complexity.

If a firm has a succession plan in place, part of the plan might be the movement of the former CEO from the CEO position to chairman of the board or board member after his retirement while his internally groomed successor moves into his role as CEO (Vancil (1987) and Naveen (2006)). We include an indicator variable that is equal to one if the successor CEO is an internal hire and zero otherwise. We expect likelihood of reappointing a former CEO as a board member to be positively related to this indicator variable. An experienced former CEO on the board will be particularly valuable in firms where the new CEO is inexperienced. We include the age of the successor CEO as a measure of inexperience.

CEO specific characteristics potentially are important determinants of the reappointment decision, but it is less clear whether these characteristics are proxies for the desire of the board to retain a high quality CEO or if these characteristics are proxies for the power and entrenchment of a former CEO who can impose his will to remain on the board. For example, we include the

tenure and founder status of the former CEO. These attributes could measure the quality of the CEO. As a CEO spends more time in the office, he accumulates more knowledge about the firm and industry, and founders know their business very well. On the other hand, a long prior tenure and founder status also are good measures of power and potential entrenchment.⁵ We also control for a CEO's share ownership at the time of his retirement.

2.2. Corporate decisions after the reappointment decision

2.2.1. Evaluation of the successor CEO

It may be valuable to have a former CEO on the board because he can help evaluate his successor. Several papers have argued that CEOs are sometimes paid for luck or forced to resign for reasons beyond their control, which suggests that it may be difficult to separate skill and luck in managerial decisions (e.g., Daines, Nair and Kornhauser (2005), Bertrand and Mullainathan (2001), and Jenter and Kanaan (2008)). A former CEO may have the ability to better assess the quality of the current CEO and possibly be better able to more quickly identify a poorly performing successor because he knows the business very well. In this case, we would expect the turnover of the current CEO to be more sensitive to performance in years that the former CEO is a director. We follow Jenter and Kanaan (2008) and estimate two-stage Cox proportional hazard regressions that separate a peer-group component from the firm-specific

⁵ Adams, Almeida and Ferreira (2005) include an indicator variable for founder status as a proxy for CEO power. Consistent with the management literature (Donaldson and Lorch (1983) and Finkelstein (1992)), Adams, Almeida and Ferreira (2005), and Fahlenbrach (2008) consider CEOs who also are founders to be more influential, and show that they perform better. Boone et al (2006) include CEO tenure and CEO share ownership as proxies for CEO influence and document that the fraction of independent directors is negatively related to these variables.

component of performance. This approach enables us to analyze whether firms with former CEOs on board focus on the performance that is most under the control of the successor CEO.

Given the extant research on CEO turnover, we also expect the tenure of the successor CEO to be related to CEO age (e.g., Warner, Watts and Wruck (1988), Huson, Parrino and Starks (2001), and Kaplan and Minton (2008)).

2.2.2. *Changes in corporate policies and changes in performance*

A former CEO on the board can potentially be a mentor and valuable resource for the successor CEO. The former CEO could advise the new CEO on how to run the business, and bring stability and continuity to the firm (e.g., Vancil (1987) or Naveen (2006)). Recent empirical evidence suggests that firms carefully choose the structure of their boards. If boards have, for example, the need for more firm-specific advice, they have boards with a higher fraction of insiders (e.g., Coles, Daniel and Naveen (2008)).

On the other hand, reappointing a strong former CEO to the board could come at a cost. For example, a 2003 *Business Week* article raised concerns about having retiring CEO Sanford Weill on the board after retirement.⁶ As pointed out in the article, the new CEO (Charles Prince III) may be undermined by the former CEO who is a board member and in a powerful position to “*cramp Prince’s style*”, i.e. to question new strategies suggested by the new CEO. Weisbach (1995) documents that CEO turnovers that are initiated by the board and normal retirement both lead to divestitures of poorly performing assets. He concludes that these results suggest that CEO turnover is important because it is part of the process of reversing managerially motivated

⁶ See Lavelle (2003).

acquisitions. One potential cost of the former CEO staying on the board is that there may be no implementation of such necessary changes.

We examine changes in corporate policies and relate them to changes in corporate performance of the firm. Similar to the approach of Bertrand and Schoar (2003) and Cronqvist and Fahlenbrach (2008), we estimate regressions of changes in investment and financial policies on control variables and treat the residual of these regressions as the unexpected change in corporate policies. In a second step, we regress the absolute value of the residual on an indicator variable that is equal to one if the former CEO is a director and zero otherwise. A negative coefficient on the indicator variable would suggest that corporate policies change less when the former CEO is on the board.

More continuity in corporate policies could be beneficial for the firm, for example, if the business model is doing well and does not need to be changed. On the other hand, more continuity could be detrimental to the firm if necessary changes in policies are blocked. We examine a benchmark-adjusted change in performance around the turnover event to distinguish between the two hypotheses.

2.2.3. Decision to rehire the former CEO

Parrino (1997) shows that the availability of a strong CEO candidate is an important consideration in the decision to replace a poorly performing CEO. For example, exceptionally poor firm performance under the current CEO may trigger the need for an unanticipated quick turnover without adequate time for succession planning. A firm may be more willing to initiate a search process if a viable alternative solution to the problem exists – the availability of its former CEO who still sits on the board of the firm, a proposition originally made by Vancil (1987).

Several recent papers have argued that the supply side of the market for CEOs is relatively scarce (Himmelberg and Hubbard (2000), Gabaix and Landier (2008), and Rajgopal, Shevlin and Zamora (2006)). If this is the case, then former CEOs on the board represent a readily available and valuable source of labor. This option is more likely to be exercised the poorer is firm performance under the current CEO.

We look at the actual incidences of former CEO directors coming back to the CEO position to shed light on what drives rehiring decisions. In this analysis it is important to account for sample selection. It is likely that only certain types of CEOs stay on the boards of their former employers, and that the characteristics that determine the decision to stay on the board are correlated with the characteristics that drive the decision to come back to run the firm again. We use the procedure suggested by Heckman (1974) to account for such a sample selection bias.

3. Data and Sample Description

We use data from four different sources. We obtain our initial sample of CEO turnovers from the ExecuComp database. Our sample period is 1994 to 2004. Compustat provides data on accounting variables, CRSP data on returns, and CompactDisclosure and proxy statements data on the board of directors. We exclude interim CEOs from our sample, which we define as CEOs with a tenure of less than six months. After imposing a requirement that the tenure be at least six months, our sample contains approximately 2,100 turnover events.

For each CEO turnover in our sample, we examine whether the former CEO is nominated as a director after he retired as CEO. We match the name of the prior CEO to the list of directors obtained from the monthly CompactDisclosure compact discs and verify whether the prior CEO

was a nominee for a director position one year and two years after retirement. For example, a CEO who steps down in December 2002 and serves on the board until his term expires at the annual meeting in April 2003 would not be considered a former CEO director. Only when the former CEO is reappointed at the annual meeting in April 2003 for a new term do we consider him a former CEO director who is reappointed once. If he is again nominated in April 2004, we consider him reappointed twice. For firms in which we are unable to match CEOs to the director list from CompactDisclosure, we manually check the proxy statements to identify whether the former CEO was reappointed to the board of directors.

To identify whether a previous CEO was rehired, we search whether the name of an executive appears twice in the time-series of CEOs on ExecuComp. For each of these instances, we verify that the previous CEO was indeed rehired, and that it is not a coding mistake (e.g., there are several cases of an alternate reporting of co-CEOs). We identify 58 events in our sample of firms which qualify as a rehiring decision. One obvious concern regarding rehired CEOs is whether they merely come back as an interim CEO while the firm is conducting an executive search. We address this issue by implementing a six-month tenure requirement to qualify as a rehired CEO.⁷

Our analysis that examines under what circumstances a firm rehires its former CEO requires that the former CEO was indeed available to be rehired. We assume that every former CEO who is a board member at the turnover of his successor is available to be rehired.⁸ We are understating the pool of available former CEOs, as a retired or fired CEO may choose or have to

⁷ An alternative approach is to search all announcements and the first annual report after the reappointment for the words interim or temporary in connection with the rehired CEO. The weakness of this approach is that a CEO may originally intend to stay as an interim CEO, but then continues in office for many years.

⁸ Theoretically, a former CEO could remain on the board of his own firm, but move on to become an executive at a different firm. However, even the unconditional probability of stepping down as a CEO and becoming an executive at a different firm is very low. Gibbons and Murphy (1992) estimate it to be 2.2%, and Brickley, Linck and Coles (1999) estimate it to be 3.2%.

leave the board of directors at retirement, yet still be able and willing to come back to his former employer (e.g., Steve Jobs at Apple). However, to include these CEOs in our study, we would have to make more subjective assessments about availability of former CEOs (e.g., is a former CEO who stepped down due to health issues available or not?), which appears undesirable. Interestingly, all but two rehired CEOs from our sample sat on the board of directors when they were rehired.

Table 1 tabulates the number of overall turnovers and statistics related to the board service of former CEOs. Column one reports the total number of turnovers. The second (third) column reports the percentage of former CEOs who are reappointed as directors at least once (at least twice) after they retired. There does not appear to be any obvious time trend. More than 50% of former CEOs are reappointed at least once as directors after they retire, and about 35% are reappointed a second time. Brickley, Coles, and Linck (1999) report that during the period from 1989 to 1993 50% of former CEOs are directors one year after they retired.⁹

The last column shows the percentage of rehired former CEOs. From 1994 to 2004, we observe 58 turnovers (2.8% of the total sample) in which a former CEO director was rehired as CEO, without an obvious time trend.

Table 2 reports CEO characteristics for the former CEO and the successor CEO. Columns 1 and 2 report means and medians for the subsample of firms that reappoint the former CEO as a director at least once, and columns 3 and 4 report means and medians for all other firms. Overall, there are significant differences in the characteristics of the former CEOs for these two samples. For the sample in which the former CEO is reappointed to the board, the former CEO is a founder of the company 20.4% of the time, has an average tenure of 9.43 years,

⁹ Their result is consistent with ours, because a former CEO who is reappointed as director once after he retired will serve on the board anywhere between 1 year and 1 year and 364 days.

owns 2.87% of the firm's stock when he first left the CEO position, and has annualized excess returns of -0.56% and -2.76% during his tenure and during the last two years as a CEO, respectively. These numbers are statistically greater than those for the sample of former CEOs who do not get reappointed to the board. In this latter sample, the former CEO is a founder 9.38% of the time, has an average tenure of 6.63 years, owns 1.81% of the firm's outstanding stock at retirement, and has poor annualized excess returns of -10.9% and -15.26% during his tenure and during the last two years as CEO, respectively. These performance differences are similar to the ones reported by Brickley, Linck and Coles (1999).

There also are significant differences in the characteristics of the successor CEO for the two samples. The average tenure of the successor CEO in the sample in which the former CEO is reappointed to the board is significantly longer (6.21 years) than that of the successor CEO in firms in which the former CEO does not stay on the board (5.19 years).¹⁰ These two groups of CEOs also differ with respect to age and percentage of internal hires. The average age of the successor CEO in the sample in which the former CEO stays on the board is significantly lower than that of the successor CEO in the sample in which the former CEO does not stay on the board. The former group has a larger percentage of internal hires (74.3%) than that of the latter group (64.43%).

Table 3 presents descriptive statistics on firm characteristics for the sample of firms in which the former CEO is reappointed as a director at least once and the sample where the former CEO does not stay on the board. The last two columns of Table 3 report the p-values for the differences in means and medians between the two groups. The accounting variables are taken from the last 10-K available prior to the turnover of the successor CEO.

¹⁰ Note that CEO tenure is relatively short because many of the successor CEOs are still in office at the end of our sample period.

Firms with former CEO directors have better growth opportunities than firms where the former CEO does not stay on the board, as evidenced by the significantly higher Tobin's q and sales growth. Firms in which former CEOs are directors are performing better, where performance is measured by return on assets (ROA). The two groups do not differ in firm size. The two groups of firms also are not statistically different with respect to other accounting ratios and measures of complexity such as capital expenditures, net PPE, R&D expenditures, cash holdings, dividends per share, high tech classification, and the measure of industry homogeneity of Parrino (1997).

4. Empirical results

4.1. Determinants of the decision to reappoint the former CEO as board member

In Table 4, we estimate probit regressions of the probability that the CEO is reappointed to the board of directors after his retirement. We estimate this probability for two groups: the former CEO is reappointed as a board member at least once (columns 1 and 2) and the former CEO is reappointed at least twice after he stepped down as CEO (columns 3 and 4). The table reports marginal effects.

Consistent with the findings of Brickley, Linck and Coles (1999), the probability of remaining on the board at each horizon is positively and significantly related to the firm's stock performance, which we measure as the stock return in excess of the market over the past two years prior to the CEO's retirement.¹¹ A one standard deviation increase in the abnormal return

¹¹ The results are robust to many different specifications of excess performance. In untabulated regressions, we have also estimated the regression with the excess performance of the former CEOs during his last years in office, and over his entire tenure. The results are qualitatively and quantitatively similar, suggesting that late career performance

over the past two years of the CEO's tenure (0.38) increases the probability of the former CEO being reappointed to the board at least twice after retirement by about 6.8%. This is economically meaningful given the unconditional mean of a former CEO being reappointed at least twice is 36%. Also consistent with Brickely, Linck and Coles (1999), accounting performance (measured by return on assets) is not statistically related to the probability of a former CEO being reappointed to the board.

Characteristics of the former CEO are important determinants of the probability of a former CEO being reappointed to the board, with economically large effects. A longer tenure of the former CEO makes it more likely that he is reappointed to the board after retirement. If a former CEO is a founder, then the probability that he is reappointed is, depending on the specification, between 12.6 and 17.6% higher than if he is not a founder. Higher share ownership of the former CEO also is positively and statistically related to being reappointed but the effect is smaller in economic magnitude. A one standard deviation increase in share ownership (5.98%) increases the probability of being reappointed at least twice to the board by about 3.5%. Recent empirical work by Boone et al (2006) use CEO tenure and share ownership as proxies for CEO influence. Given this interpretation, our results suggest that influential CEOs are more likely to be reappointed as board members, and hint at the possibility of power struggles between influential and successful former CEOs and their successors. Finally, if the former CEO is of retirement age, which is correlated with voluntary turnovers, the probability of being reappointed twice to the board increases by about 12%.

Interestingly, characteristics of the successor CEO also appear to play a role in the reappointment decision. The probability of the former CEO staying on the board is higher for

and entire career performance are both important for the probability of retaining a board seat after retirement. Also, we have estimated regressions with performance in excess of the Fama and French (1997) 48 industry return, again with qualitatively and quantitatively similar results.

younger successor CEOs. For example, a former CEO is eight percent more likely to be reappointed at least once after retirement if the firm's successor CEO is 10 years younger than other CEOs. The former CEO is more likely to be reappointed to the board if his successor is an internal candidate. The probability of being reappointed to the board at least twice after retirement is about 11% higher if the successor CEO is an internal hire. This is consistent with an internal succession process as described in Vancil (1987) or Naveen (2006), but also with the notion that external hires may be more reluctant to join the firm if a clean transfer of power is not assured.

Smaller firms are more likely to reappoint the former CEO to the board at least twice after retirement. A one standard deviation decrease in firm size is associated with a five percent increase in the probability of being reappointed twice. This result is consistent with Boone et al (2006) who show that smaller firms have a lower fraction of independent directors. Other firm characteristics that measure the level of firm-specific capital surprisingly do not appear to play a role in the reappointment decision.

4.2. Corporate decisions after the reappointment decision

In this section, we examine corporate decisions and policies after the decision to reappoint a former CEO to the board of directors. We examine the relation between a former CEO remaining on the board and the tenure and relative performance evaluation of the successor CEO in Section 4.2.1. In Section 4.2.2, we examine the changes in corporate policies and changes in firm performance around the turnover decision. In Section 4.2.3, we study the decision to rehire the former CEO.

4.2.1. Is successor CEO relative performance evaluation affected by the former CEO's directorship?

We predict the probability of CEO turnover when the former CEO is director using Cox proportional hazard regressions. The proportional hazard model estimates the probability that a CEO who has been in office for a certain amount of time will leave during the next time interval. The model also takes into account that not all firms have a turnover event during our sample period and therefore can be estimated with censored panel data.

Our specification follows Jenter and Kanaan (2008) who estimate a two-stage model. Their first stage ordinary least squares regression decomposes firm performance into a systematic component caused by peer-group performance and a firm-specific component that reflects, at least partially, CEO ability. In the second stage, they estimate a Cox proportional hazard model predicting the probability of a CEO turnover using the systematic and the residual component of firm performance from the first stage. The residual component measures how sensitive turnover is to performance once “luck” has been removed from firm performance. We follow their approach and calculate the systematic and residual component each year. In the second stage, we interact both the systematic and residual component of firm performance with an indicator variable equal to one if the former CEO was a director in that year, and zero otherwise, to determine the incremental effect of the former CEO on relative performance evaluation.

Table 5 reports the results. Panel A of the table reports first-stage results. First stage peer-group performance is defined as the equal-weighted Fama-French (1997) 49 industry return (column 2) or the CRSP equal-weighted market return (column 3), respectively. As expected, and consistent with Jenter and Kanaan (2008), industry and market returns are highly correlated

with firm stock returns. For example, industry performance is a strong predictor of firm performance with a coefficient equal to 0.78 and a t -statistic equal to 13.8, and industry return explains 16.4% of the variations in firm return.

Panel B of the table reports the results of the Cox proportional hazard model. The table reports hazard ratios. A coefficient larger than one indicates that an increase in the independent variable leads to an increase in turnover probability. Column 1 (base-case) reports results of a simple model without the first stage which only controls for the age of the successor at the appointment, an indicator variable equal to one if the CEO is in retirement age (between 63 and 66 years old), and the high-tech indicator variable of Loughran and Ritter (2004). Columns 2 and 3 of Panel B show the results of the second stage of the two-stage model described above.

The base-case regression shows that the probability of staying another year in office increases with firm size and if the firm operates in a high-tech industry. These results are consistent with the notion that it is more difficult to evaluate a CEO and to find a replacement in more complex firms. If the successor CEO is promoted from within the firm, he is less likely to turn over. Perhaps not surprisingly, the probability of turnover in the next period is much higher if the CEO is of retirement age, or if he was older when he was first appointed.

As reported in Table 5, column 2 (Panel B), the presence of the former CEO as a director makes it less likely that the CEO turns over. Adding firm performance has little effect on the other right-hand side variables. The coefficient on the predicted value from the first stage regression is not statistically significant, suggesting that, in our sample of all turnovers, peer-group performance, as measured by Fama-French industry performance, does not affect the probability of CEO turnover.¹² The interaction of former CEO director and peer-group

¹² This result is similar to the result on voluntary turnovers reported in Table 10 of Jenter and Kanaan (2008).

performance also is not significant. Table 5 shows, however, that CEO turnover is strongly predicted by poor idiosyncratic firm performance. This result is consistent with extant research on CEO turnover. More importantly, the coefficient on the interaction term of idiosyncratic firm performance and former CEO director is smaller than one, which suggests that CEO turnover is significantly more likely if idiosyncratic performance is poor and the former CEO sits on the board. Because the idiosyncratic performance measure filters out performance beyond the control of the CEO, our result indicates that board of directors that contain the former CEO are better at evaluating the performance of the current CEO.

Column 3 of Table 5, Panel B, shows results when the peer-group performance evaluation is not the Fama-French industry, but the entire equal-weighted market. A similar result holds; poor idiosyncratic performance increases the probability of turnover during the next period, and the effect is significantly stronger when the former CEO is a director.

Overall, our results are consistent with the idea that boards with former CEOs can better spot a poorly performing CEO and move for his dismissal faster. If it does so, the board is making its decision using the right performance criteria.

4.2.3. Former CEO directors, corporate policies, and firm performance

In most cases (74%) in which a firm reappoints the former CEO as director, the current CEO was an employee of the firm, who was likely groomed by the former CEO and the board of directors for his new position. Does the former CEO advise his successor and help him succeed, or does the former CEO's board membership create a power struggle in the firm when the new CEO seeks to implement his own plans?

Tables 6 and 7 attempt to answer these questions by analyzing changes in corporate policies and firm performance around the succession event. For each corporate policy, we estimate an ordinary least squares regression of the change in the corporate policy from the two years prior to the turnover to the two years post turnover,¹³ controlling for firm size, firm age, past performance, and industry and year indicator variables (results are omitted for brevity). We then take the absolute value of the regression residual and use it as a measure of idiosyncratic firm behavior. In a second step, we estimate a regression of the absolute value of the first stage residual on a former-CEO director indicator variable to investigate whether the idiosyncratic change is related to the presence of a former CEO (for a similar approach, see Bertrand and Schoar (2003)). The indicator variable is equal to one if the former CEO has been reappointed as director at least twice after his turnover, and zero otherwise. Table 6 contains regression results of this second step. Each row in Table 6 corresponds to a separate regression. We report the coefficient and heteroscedasticity-consistent standard error of the former CEO director variable as well as the total number of observations of the second stage regression in Table 6, columns 1 and 2, respectively.

Overall, there is weak evidence in Table 6 that corporate policies in firms in which the former CEO sits on the board change less across a turnover. All but two regressions show a negative coefficient on the former CEO director indicator variable, and about half of them are statistically significant. We can gauge the economic magnitude of the effects by relating the coefficient estimate reported in Table 6 to the average absolute value of the first-stage residual. For example, firms with former CEOs as directors have a 19.4% smaller idiosyncratic change in

¹³ For example, if a firm has a fiscal year end in December, and a turnover happens in September 2000, we calculate the change as the average of the corporate policy in fiscal year 2001 and 2002 minus the average of the corporate policy in fiscal year 1998 and 1999. The turnover year is left out.

dividends, a 19.8% smaller idiosyncratic change in market leverage, and a 13.8% smaller idiosyncratic change in selling, general, and administrative costs.

However, it is more difficult to draw conclusions about whether the smaller changes in corporate policies documented in Table 6 are beneficial or detrimental to the firm. For example, there is an 11.5% smaller idiosyncratic change in the ratio of net PPE to total assets when the former CEO is director, but it is unclear whether that result means that it is more difficult to divest underperforming assets that were bought by the former CEO when the former CEO sits on the board (see Weisbach (1995)), or whether it means that the firm is just a better firm that may not have to change its asset structure to perform well.

One indirect way to address the performance impact of the smaller changes in corporate policies is to examine benchmark adjusted changes in return on assets (ROA) post turnover. If the smaller changes in corporate policies are a result of a power struggle between the former and new CEO, we would expect corporate performance to suffer post turnover. We use an industry and performance matched benchmark, as suggested by Barber and Lyon (1996) and Holthausen and Larcker (1996) to detect any abnormal performance.¹⁴ We implement such a test as follows. Excess performance is calculated as the difference between the ROA of sample firms and the mean ROA of a group of control firms. For each sample firm, we generate a group of control firms matched on industry, size, and prior performance. Industry is the Fama and French (1997) 49 industry. Size is the market value of equity measured in the fiscal year immediately before the turnover event. Prior performance is the average ROA over the two most recent years before the turnover event. Firms are in the control sample if they are in the same industry and if their size and prior performance is within +/- 30% of those of the sample firms.

¹⁴ Barber and Lyon (1996) evaluate the empirical power and specification of nine accounting performance measures and an appropriate test to detect abnormal performance and find that a past-performance-matched benchmark is most appropriate and that a non-parametric Wilcoxon test is the most powerful test.

Table 7 compares excess accounting performance of firms that reappoint the former CEO to the board after his retirement (columns 1 and 2) with the excess performance of firms that do not (columns 3 and 4). The first row shows the excess performance during the first full year after the turnover. The second row shows the average excess performance during the first two full years after the turnover.

It is evident from Table 7 that firms that retain their former CEOs as directors do as well as the benchmark group. In contrast, firms that do not retain their former CEOs perform worse than the benchmark group and the group of firms with former CEO directors. The average underperformance of firms that do not retain their former CEOs is an economically significant -1.8% in the year following the turnover.

Overall, the results are inconsistent with the notion that, ex post, firms with former CEO directors often experience power struggles that hurt firm performance. If former CEOs only agree to be directors because they are afraid that new CEOs will destroy their legacy, then we should have observed worse performance as changes in corporate policies or strategies are blocked or undermined.

It is important to point out that legitimate endogeneity concerns limit the conclusions one can draw from the results in Tables 6 and 7. In particular, because former CEOs are not randomly reappointed to the board of directors, one should not interpret our results as evidence that firms that did not reappoint their former CEOs as directors could have done better had they made the reappointment decision. Rather, our results are consistent with a board of directors reappointing the former CEO to the board only if it is ex ante the optimal decision to do so. The reappointment of former CEO directors may be especially desirable for firms that require few changes in corporate policies and that expect to do well in the future. Along similar lines, it is

possible that former CEOs are often asked to remain on the board of directors but only choose to do so when they expect the firm to do well and when they feel their advice is appreciated.

4.2.3. Decision to rehire former CEOs

In this section, we focus on an extreme situation in which the former CEO director may be particularly valuable. In about 300 sample observations, the former CEO sits on the board of directors at the turnover of his successor. Obviously, these firms have experienced difficulties under the successor CEO, because they decided to terminate him quickly. In approximately 20% of these cases, the former CEO returns for a second time as CEO. Vancil (1987) was the first to acknowledge the value of a former CEO on the board in this particular situation, but to the best of our knowledge, there is no empirical evidence on the circumstances in which such rehiring decisions happen.

Table 8 reports summary statistics of the sample we use in this subsection. The first two columns show, respectively, means and medians of characteristics of the rehired CEO, his successor, and firm characteristics. The third and fourth column show, in comparison, characteristics of former CEOs who are directors at the turnover of their successors, but did not come back to run the firm again. Table 8 shows that former CEOs who were rehired were significantly more successful during their first tenure. The median performance in excess of the market of the rehired CEOs during their first tenure was more than 6%, compared to a median market-adjusted performance of -1.92% for the sample of CEOs who sat on the board of directors, but were not rehired. Also, rehired CEOs appear to be more involved in the firm or have more influence, as measured by their founder status, chairman of the board status, and share

ownership.¹⁵ It is worth noting, though, that even the control sample has CEOs that have high levels of these attributes compared to the overall sample (see Table 2). For example, former CEO directors are founders in 27% of all control group firms and chairman of the board in 41% of all control group firms. These statistics suggest that it is only certain CEOs that stay on the board until the turnover of their successors, no matter whether they come back out of retirement or not.

Strikingly, 75% of the successor CEOs were internal candidates in the rehired CEO sample, potentially groomed by the former CEO. Yet, these internal hires have an average tenure of less than two years. Their tenure is extremely short, potentially because they deliver an annualized market- or industry-adjusted performance of a staggering minus 25%. These numbers are more dramatic than those of the control sample, in which the successor CEOs have an average tenure of approximately three years and an annualized underperformance of approximately minus 13%. Firm characteristics such as size, tangible assets, or investments do not appear to be different across the two groups, although there is some evidence that firms in which the former CEO is rehired have better growth opportunities.

In Table 9, we examine the determinants of the decision to rehire the former CEO who sits on the board at the time of the successor CEO's turnover. We saw in Table 8 that the sample selection criterion that the former CEO is a board member at the turnover of his successor yields a biased sample with more forced turnovers, successor CEOs with short tenure, and different characteristics of the former CEO. Consequently, it is important to account for sample selection in the rehiring regressions. Only certain types of CEOs are retained on the board after retirement and it is likely that the characteristics that determine the decision to retain former CEOs on the

¹⁵ The differences between the two groups appear economically large, but because of the small sample size, not all of the differences are statistically significant.

board until the turnover of their successors are correlated with the characteristics that drive the decision to come back to run the firm again. We use the two-stage selection model suggested by Heckman (1974) to account for such a sample selection bias. The first stage estimates the determinants of the probability that the former CEO stays on the board after retirement until the turnover of his successor. We include the same variables in the first-stage regression that were strong predictors of the decision to reappoint the former CEO to the board after his retirement (Table 4).

The second stage models the likelihood that a firm rehires the former CEO given that the former CEO is on the board at the time of the successor CEO's turnover. We take into account the binary nature of the first-stage left-hand side variable and estimate a Heckman Probit model. We use a Wald test of independence of selection and principal equation to gauge whether the decision to retain the former CEO on the board and the decision to rehire the former CEO as a CEO are independent of each other. The Wald statistic in Table 9 rejects the independence of selection and principal equation at the ten percent level, suggesting that our concerns about sample selection are justified.

As reported in Table 9, column 1 (selection equation), the former CEO is more likely to remain on the board of directors until the turnover of his successor the more successful he was during his tenure, if he is the founder of the firm, the larger is his stock ownership at retirement, the younger is his successor, and the smaller the firm. These results are similar to the ones we report in Table 4 where we analyze the decision to reappoint the former CEO to the board at least once or twice after his retirement.

The results for the principal equation in Table 9 show that, controlling for the likelihood that the CEO remains on the board, the probability of rehiring a former CEO is significantly

related to CEO and firm characteristics. The probability that the former CEO is rehired is 17% higher if the former CEO is chairman of the board at the time of the successor CEO's turnover. This marginal probability is significant at the one percent significance level. The former CEO is more likely to come back to run his firm if he has spent fewer years in retirement. Each additional year in retirement reduces the probability of a comeback by approximately 2.5%.

Stock performance also is correlated with the likelihood of rehiring a former CEO. The probability that a firm will rehire a former CEO increases by 9% if the current CEO is a bottom quartile performer. While Denis and Denis (1995) and Warner, Watts and Wruck (1988) document a positive relation between poor stock performance and an external hire, our finding suggests that for firms with particularly poor performance, the board hires an internal candidate – the former CEO. While firm size is negatively related to the probability of the former CEO staying on the board, the probability of rehiring the former CEO given that he stays on the board is positively related to firm size.

The rehiring decision depends on both the willingness of the former CEO to serve again and on the board of directors' demand for the services of the former CEO. The evidence in Table 9 is supportive of both. Former CEOs who are still chairmen or who were retired for fewer years may be relatively more willing to come back into office as they have not fully separated from the firm. Firms rehire former CEOs when performance is rapidly deteriorating, indicating the need for a quick turn around. What is more surprising, however, is that the former CEO is putting his reputation on the line and comes back after the firm has lost approximately fifty percent of its market value. His willingness to come back under these circumstances suggests that he thinks he can turn the firm around.

To explore this possibility, we study what happens to firm performance once the former CEO comes back to run the firm again. We again use an industry and performance matched benchmark to detect any abnormal accounting performance, but use the procedure suggested by Larcker (2003).¹⁶ The median abnormal ROA, calculated as described above, for the first year of the rehired CEO is 0.23% and is not statistically different from zero.¹⁷ Thus, the rehired CEO appears to perform as well as a CEO of a different firm from the same industry with a similar accounting performance in the preceding year. Our results suggest that performance does not decline under the rehired CEO. While we believe that this association is interesting in its own right, we again caution the reader not to interpret the result as a causal statement. While it is consistent with a stable performance of the firm under the rehired CEO, it is also possible that the former CEO only agreed to come back to run the firm again because he anticipated that performance would be stable or had a good strategic plan to deliver stable performance.

5. Conclusion

Fifty four percent of retired CEOs are reappointed to the board of directors of their firms at least once after their retirement. In this paper, we study the determinants of the reappointment decision and corporate decisions for firms that reappoint their former CEO compared to those that do not. Overall, our evidence is consistent with a board of directors reappointing successful former CEOs when the firm can benefit from their advice.

¹⁶ Larcker (2003) suggests using a matched firm approach for smaller samples such as the one we study in this section. For the first year of each comeback CEO, we find a matched firm from the same industry that had a similar performance in the previous fiscal year t-1 (the last year of the current CEO). We then calculate abnormal accounting performance in year t by deducting the ROA of the benchmark firm from the ROA of the comeback CEO's firm.

¹⁷ The results are quantitatively and qualitatively similar if we use means instead.

We find that the tenure, stock market performance and founder status of the former CEO are strong predictors of the probability that the former CEO is reappointed to the board after retirement. Also, if the successor CEO is young or is an internal candidate, it is more likely that the former CEO is reappointed.

Using a Cox proportional hazard model, we examine the impact of the presence of the former CEO on the board on the successor CEO's tenure. We find that the successor's probability of turnover is more responsive to idiosyncratic firm performance in years in which the former CEO is on the board of directors. The result suggests that the former CEO helps the board evaluate his successor and is able, perhaps from his own experience running the firm, to filter out poor industry or market performance and focus on the idiosyncratic component of firm performance that is under the control of his successor.

Contrary to allegations that former CEOs on the board could undermine the authority of the new CEO or block the implementation of a new strategy, we do not find that the average reappointment of a former CEO to the board leads to power struggles in the board room that would decrease performance by preventing necessary changes in corporate policies.

We analyze the extreme case of firms that come to rely on their former CEO directors by rehiring them as CEO. We find that former CEOs are more likely to be reappointed if the firm has done very poorly and if the former CEO still has strong ties to the firm, either because he was chairman of the board or only retired for a short time. The appointment is not temporary – the former CEO stays on average two and a half years as CEO.

Our results cast doubts on the strong, unconditional regulatory requirement for more independent directors mandated by, e.g., the Sarbanes-Oxley Act. Our paper shows that inside directors such as former CEOs can and do provide valuable services to the firm, and that the

average board of directors carefully selects which former CEOs to retain on the board and which former CEOs to turn to in difficult situations.

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Appendix A: Variable Definitions

This appendix describes the COMPUSTAT variables we used in our analysis. When calculating the ratios, the variables are taken from the same COMPUSTAT year unless specified otherwise.

Variables:

BE (Book value of Equity) = Shareholders' equity (216) [or common equity (60) + preferred stock carrying value (130) or Assets (6) – total liabilities (181)] – Preferred stock liquidating value (10) [or preferred stock redemption value (56), or preferred stock carrying value (130)];

ME (Market value of Equity) = Fiscal year end market price (199) * Shares outstanding (25);

Debt = Long-term debt (9) + Debt in current liabilities (34);

Acquisitions / Assets = Acquisition costs (129) / Assets (6);

CAPEX / Assets = Capital expenditure (128) / Assets (6);

Cash / Non-cash Assets = Cash (1) / [Assets (6) – Cash (1)];

Book Leverage = Debt / (Debt + BE);

Market Leverage = Debt / (Debt + ME);

Number of Employees = Number of employees (29)

PPE / Assets = Net PP&E (8) / Assets (6);

R&D / Sales = R&D expenditure (46) / Sales (12);

ROA = [Income before extraordinary items (18) + Interest expenses (15)] / Assets (6)

Sales Growth_t = Sales (12)_t / Sales (12)_{t-1} – 1;

SG&A / Sales = SG&A expenses (189) / Sales (12);

Tobin's q = [Assets (6) + ME – BE] / Assets (6);

Table 1: Frequency of CEO Turnovers and Former CEO-directors

The Table lists the number of CEO turnovers of our sample, by year. The sample construction is described in detail in section 2. The first column of the table shows the total number of turnovers in our sample. The second and third column show the fraction of observations in which the former CEO is reappointed as a director at least once (column 2) or at least twice (column 3) after his retirement. The last column reports the fraction of cases in which the firm reappoints a former CEO as CEO.

| Year | Total Turnover | Former CEO is reappointed as director | | Rehired as CEO |
|-------|----------------|---------------------------------------|----------------|----------------|
| | | at least once | at least twice | |
| 1994 | 147 | 63.3% | 44.9% | . |
| 1995 | 160 | 61.3% | 47.5% | . |
| 1996 | 161 | 47.8% | 38.5% | 1.9% |
| 1997 | 194 | 55.2% | 37.6% | 3.6% |
| 1998 | 194 | 58.2% | 36.1% | 2.6% |
| 1999 | 220 | 49.1% | 30.5% | 3.6% |
| 2000 | 240 | 47.9% | 33.3% | 2.9% |
| 2001 | 213 | 52.6% | 31.0% | 2.3% |
| 2002 | 188 | 56.9% | 41.5% | 3.7% |
| 2003 | 185 | 48.6% | 30.1% | 4.9% |
| 2004 | 185 | 54.1% | 30.6% | 3.8% |
| Total | 2,087 | 53.7% | 36.0% | 2.8% |

Table 2: CEO Characteristics

The Table shows means and medians of CEO characteristics for the sample firms. The first two columns show means and medians for the sample in which the former CEO was reappointed as a director at least once after he stepped down. The third and fourth column shows statistics for all other turnovers in our sample. The last two columns contain p- and z-values of tests of statistical differences in means and medians across the two groups. *Founder* is an indicator variable equal to one if the former CEO founded the firm and zero otherwise. *Tenure* is the duration in years of the appointment as CEO. *Share ownership* is the fractional ownership of the CEO taken from the last proxy statement of his tenure. *Appointment age* is the age of the executive at which he was appointed CEO. *Retirement age* is the age at which he stepped down as CEO. *Annualized stock return* is the firm's stock return, annualized over the CEO's entire tenure. *Annualized excess return* is the firm's stock return in excess of the value-weighted market return, annualized over the CEO's entire tenure. *Annualized stock return in last 2 years* is the firm's stock return, annualized over the last two years of CEO's tenure. *Annualized excess return in last 2 years* is the firm's stock return in excess of the value-weighted market return, annualized over the last 2 years of CEO's tenure. *Internal hire* is an indicator variable equal to one if the current CEO worked for the company for at least 365 days prior to the appointment as CEO. All data are from ExecuComp, CRSP, and proxy statements.

| Former CEO | Former CEO director | | Former CEO not director | | Test of difference | |
|------------------------------------------|---------------------|--------|-------------------------|---------|--------------------|--------|
| | Mean | Median | Mean | Median | Mean | Median |
| Founder | 20.40% | | 9.38% | | <.0001 | <.0001 |
| Tenure | 9.43 | 7.28 | 6.63 | 4.66 | <.0001 | <.0001 |
| Share ownership | 2.87% | 0.46% | 1.81% | 0.21% | 0.000 | <.0001 |
| Appointment age | 51.55 | 52.00 | 50.86 | 51.00 | 0.076 | 0.013 |
| Retirement age | 60.82 | 62.00 | 57.38 | 58.00 | <.0001 | <.0001 |
| Annualized stock return | 12.23% | 12.57% | 1.09% | 5.46% | <.0001 | <.0001 |
| Annualized excess return | -0.56% | -0.73% | -10.90% | -7.12% | <.0001 | <.0001 |
| Annualized stock return in last 2 years | 8.38% | 5.87% | -4.34% | -2.73% | <.0001 | <.0001 |
| Annualized excess return in last 2 years | -2.76% | -5.25% | -15.26% | -15.51% | <.0001 | <.0001 |
| Current CEO | | | | | | |
| Tenure | 6.21 | 5.83 | 5.19 | 4.61 | <.0001 | <.0001 |
| Internal hire | 74.30% | | 64.43% | | <.0001 | <.0001 |
| Appointment age | 51.14 | 51.00 | 52.99 | 53.00 | <.0001 | <.0001 |

Table 3: Firm Characteristics of Sample Firms

The Table shows means and medians of CEO characteristics for the sample firms. The first two columns show means and medians for the sample in which the former CEO was reappointed as a director at least once after he stepped down. The third and fourth column shows statistics for all other turnovers in our sample. The last two columns contain p- and z-values of tests of statistical differences in means and medians across the two groups. The accounting variables are from the last fiscal year prior to the turnover. All variables are defined in Appendix A or Section 3.

| | Former CEO director | | Former CEO not director | | Test of difference | |
|----------------------|---------------------|--------|-------------------------|---------|--------------------|--------|
| | Mean | Median | Mean | Median | Mean | Median |
| Total Assets | 5537.18 | 988.87 | 6374.48 | 1073.51 | 0.194 | 0.223 |
| Sales | 3048.65 | 869.25 | 3562.18 | 1041.85 | 0.065 | 0.028 |
| Tobin's Q | 1.94 | 1.44 | 1.79 | 1.33 | 0.010 | 0.000 |
| ROA | 0.04 | 0.07 | 0.03 | 0.06 | 0.008 | <.0001 |
| ROE | 0.05 | 0.11 | 0.04 | 0.10 | 0.704 | 0.003 |
| Sales Growth | 0.17 | 0.09 | 0.14 | 0.07 | 0.052 | 0.001 |
| CAPEX/Assets | 0.06 | 0.05 | 0.07 | 0.05 | 0.681 | 0.735 |
| NPPE/Assets | 0.30 | 0.24 | 0.32 | 0.26 | 0.122 | 0.049 |
| R&D/Sales | 0.10 | 0.03 | 0.11 | 0.03 | 0.403 | 0.828 |
| Cash/Non_cash Assets | 0.23 | 0.06 | 0.21 | 0.05 | 0.286 | 0.558 |
| Market Leverage | 0.24 | 0.18 | 0.28 | 0.21 | 0.000 | 0.001 |
| Dividend per share | 0.66 | 0.16 | 0.42 | 0.09 | 0.106 | 0.092 |
| Industry Homogeneity | 0.17 | 0.14 | 0.16 | 0.14 | 0.736 | 0.422 |
| High-tech Industry | 0.13 | 0.00 | 0.13 | 0.00 | 0.939 | 0.939 |

Table 4: Determinants of the Reappointment of the Former CEO to the Board of Directors

The Table reports results from Probit regressions of the likelihood that a former CEO is appointed to the board of directors of his firm after retirement. The dependent variable is equal to one if the former CEO is reappointed to the board of directors at least once after his retirement (columns 1 and 2), or at least twice after his retirement (columns 3 and 4). The sample is described in section 2. The Table reports *marginal* effects. All variables are defined in Appendix A. Standard errors are corrected for heteroscedasticity and are reported in parentheses. The regressions also contain year-fixed effects and an indicator variable capturing missing information for CEO share ownership (not reported). Statistical significance at the 1%, 5%, and 10% level is indicated by ***, **, and *, respectively.

| | Former CEO is re-appointed as board member | | | |
|-----------------------------|---------------------------------------------------|----------------------|-----------------------|----------------------|
| | At least once | | At least twice | |
| ROA | 0.069 (0.097) | 0.078 (0.105) | 0.115 (0.094) | 0.076 (0.103) |
| Annualized excess return | 0.140*** (0.035) | 0.136*** (0.035) | 0.180*** (0.033) | 0.179*** (0.034) |
| Log(tenure) | 0.054*** (0.013) | 0.060*** (0.014) | 0.042*** (0.013) | 0.050*** (0.014) |
| Founder | 0.137*** (0.035) | 0.126*** (0.036) | 0.176*** (0.037) | 0.167*** (0.037) |
| Share ownership | 0.461 (0.281) | 0.432 (0.280) | 0.657*** (0.250) | 0.582** (0.247) |
| Retirement age | 0.152*** (0.027) | 0.159*** (0.028) | 0.118*** (0.029) | 0.127*** (0.029) |
| Age of successor CEO | -0.008*** (0.002) | -0.007*** (0.002) | -0.005*** (0.002) | -0.005*** (0.002) |
| Successor CEO internal hire | 0.090*** (0.027) | 0.095*** (0.027) | 0.114*** (0.024) | 0.116*** (0.025) |
| Log(Assets) | -0.014* (0.007) | -0.018** (0.008) | -0.028*** (0.007) | -0.032*** (0.007) |
| NPPE / Assets | | -0.107* (0.056) | | -0.087 (0.055) |
| R&D / Sales | | -0.033 (0.058) | | -0.091 (0.057) |
| Industry homogeneity | | 0.170 (0.178) | | 0.039 (0.172) |
| High-tech indicator | | 0.029 (0.036) | | 0.014 (0.036) |
| Observations | 1928 | 1876 | 1927 | 1875 |
| Observed probability | 0.547 | 0.546 | 0.366 | 0.367 |
| Predicted probability | 0.550 | 0.549 | 0.351 | 0.351 |
| Pseudo R-squared | 0.077 | 0.080 | 0.096 | 0.101 |

Table 5: CEO Turnover and Firm- and Peer-group Performance

The Table reports results from Cox proportional hazard regressions of CEO turnover. The data are right-censored because not all current CEOs experience a turnover in our sample. The base-case specification (column 1) estimates the regression using CEO-specific control variables only and has no first stage. The specifications in column 2 and 3 are based on two-stage regressions. In the first stage regressions (Panel A), Fama French (1997) equal weighted 49 industry returns (column 2) or equal-weighted market returns (column 3) are used to predict contemporaneous company stock returns. The second stage Cox hazard regressions (Panel B) predict CEO turnover using the predicted values and the residuals from the first stage regression as estimates of the peer-group component and of the idiosyncratic component of firm stock returns. The predicted values and the residuals are interacted with an indicator variable equal to one if the former CEO is on the board of directors in a given year, and zero otherwise. The second stage regressions allow the baseline hazard rates to differ across different industries. The table reports hazard ratios. A coefficient larger than one indicates that an increase in the independent variable leads to an increase in the probability of failure (i.e., to a decrease in CEO tenure). A CEO is an internal candidate if he has worked at least one year for the firm prior to his appointment as CEO. A CEO is of retirement age if he is between 63 and 66 years old, appointment date age is the age of the CEO at his time of appointment to CEO. *Log (assets)* is measured in each fiscal year. *High-tech* is an indicator variable equal to one if the firm is operating in a high-tech industry, and zero otherwise. Peer-group induced stock return is the predicted value from the first stage regression. *t*-statistics (first stage) and *z*-statistics (second stage) are reported in parentheses. Standard errors are robust and clustered at the industry level. Statistical significance at the 1%, 5%, and 10% level is indicated by ***, **, and *, respectively.

Panel A: 1st Stage

| | base-case | firm stock return (<i>t-1</i>) | firm stock return (<i>t-1</i>) |
|--------------------------------|-----------|-------------------------------------|-------------------------------------|
| Constant | --- | 0.054*** (8.11) | 0.076*** (6.04) |
| Industry return (<i>t-1</i>) | --- | 0.773*** (13.8) | |
| Market return (<i>t-1</i>) | --- | --- | 0.675*** (6.19) |
| R-squared | | 0.164 | 0.063 |

Panel B: 2nd Stage

| | base-case | industry return | market return |
|-----------------------------------------------------|--------------------|--------------------|--------------------|
| Internal appointment | 0.837*** (2.66) | 0.825*** (2.77) | 0.829*** (2.65) |
| CEO of retirement age t | 1.503*** (2.62) | 1.513** (2.52) | 1.522*** (2.59) |
| Age of CEO at time of Appointment | 1.062*** (6.79) | 1.064*** (6.59) | 1.063*** (6.65) |
| Log (assets) $t-1$ | 0.948* (1.83) | 0.946* (1.91) | 0.945* (1.88) |
| High-tech indicator | 0.778** (2.29) | 0.752** (2.31) | 0.755** (2.36) |
| Former CEO director $t-1$ | | 0.798** (2.43) | 0.717*** (2.64) |
| Peer-group induced return ($t-1$) | | 1.000 (0.00) | 2.011 (1.50) |
| Peer-group induced return * former CEO director | | 0.710 (1.60) | 1.308 (0.51) |
| Idiosyncratic stock return $t-1$ | | 0.538*** (5.23) | 0.538*** (4.98) |
| Idiosyncratic stock return * former CEO director | | 0.495*** (3.36) | 0.492*** (3.67) |
| Observations | 8224 | 7953 | 7953 |

Table 6: Corporate Policy Changes across CEO Turnovers

The Table shows results from OLS regressions of the effect of former CEO directors on the absolute value of unexpected changes in corporate policies across turnovers. Each entry in the table corresponds to a separate regression. For each corporate policy and each firm, we calculate the average change of the corporate policy from the last two years the former CEO was in office to the first two years the current CEO is in office. We first estimate a regression for each corporate policy on a set of control variables (not reported). The control variables include logarithm of total assets, ROA, stock return in excess of the market over the two last years pre-turnover, a firm age variable, and indicator variables that represent the firm's Fama-French 49 industry classification and the year of turnover. In a second step, we estimate a regression of the absolute value of the residual from the first regression on an indicator variable equal to one if the former CEO was reappointed to the board of directors at least twice after his retirement. The first column reports the regression coefficients and standard errors for the variable *Former CEO Director*, and the second column the number of observations underlying each regression. A negative and statistically significant coefficient implies that the changes in corporate policy across the turnover are significantly smaller for cases in which former CEOs remained on the board of directors. Statistical significance at the 1%, 5%, and 10% level is indicated by ***, **, and *, respectively.

| Equation | Former CEO Director | |
|------------------------|-----------------------------|-------------|
| | Coefficient (Std. error) | No. of obs. |
| Dividends | -0.022*** (0.007) | 1975 |
| Cash / Non-cash assets | 0.000 (0.007) | 1974 |
| Book leverage | -0.032*** (0.007) | 1943 |
| Market leverage | -0.016*** (0.004) | 1964 |
| CAPEX / assets | -0.001 (0.001) | 1860 |
| Acquisition / assets | -0.001 (0.002) | 1763 |
| PPE / assets | -0.004** (0.002) | 1949 |
| R&D / sales | 0.002 (0.002) | 1086 |
| SG&A / sales | -0.004** (0.002) | 1617 |
| Number of employees | -0.126 (0.192) | 1948 |

Table 7: Former CEO Board Membership and Firm Performance

The Table compares excess accounting performance of firms that reappoint the former CEO to the board after his turnover (columns 1 and 2) with the excess performance of firms who do not reappoint the former CEO (columns 3 and 4). Performance is measured by ROA, calculated as Earnings before interest over assets. Excess performance is the difference of ROA of sample firms and the mean ROA of a group of control firms. For each sample firm, we generate a group of control firms matched on industry, size, and prior performance. Industry is the Fama-French 49 industry. Size is the market value of equity measured in the fiscal year immediately before the turnover event. Prior performance is the average ROA over the two most recent years before the turnover event. Firms are in the control sample if they are of the same industry and if their size and prior performance are within +/- 30% of those of the sample firms. The first row shows the excess performance during the first full year after the turnover. The second row shows the average excess performance during the first two full years after the turnover. The third row shows the number of firms. The last two columns show p-values from tests of statistical difference between the two group means (columns 1 and 3) and group medians (columns 2 and 4). Statistical significance at the 1%, 5%, and 10% level is indicated by ***, **, and *, respectively.

| | Former CEO director | | Former CEO not director | | p- and z-value of test of difference in | |
|------------------------------------------|--------------------------------|----------|------------------------------------|------------|----------------------------------------------------|--------|
| | Mean | Median | Mean | Median | Mean | Median |
| Excess ROA 1 year after the turnover | -0.043% | 0.291%** | -1.799%*** | -0.080%** | 0.001 | 0.003 |
| Excess ROA 2 years after the turnover | -0.154% | 0.181% | -1.905%*** | -0.099%*** | 0.000 | 0.004 |
| Number of firms | 826 | | 694 | | | |

Table 8: Summary statistics for the rehired CEO group against the control group

The table shows means and medians of CEO and firm characteristics for the sample of firms in which the former CEO is on the board at the turnover of his successor. The first two columns show means and medians for the rehired CEO sample, the third and fourth columns show means and medians for all other observations (the control sample), and the fifth and sixth columns contain p- and z-values of tests of statistical differences in means and medians across the rehired CEO and the control samples. A firm belongs to the rehired CEO sample if the successor CEO was the CEO at the same firm at a different point in time for at least six months, was member of the board of directors at the turnover of the current CEO, and stays on during his second tenure for at least six months. A firm is in the control sample if the former CEO was member of the board of directors at the turnover of the current CEO. Former CEO is the rehired CEO in the rehired CEO sample and the CEO in office prior to the current CEO in the control sample. The excess returns are calculated over the entire tenure of the respective CEO. All other variables are defined in Appendix A or in Section 3.

| | Rehired CEO sample (56 obs.) | | Control sample (234 obs.) | | p- and z- values for test of difference in | |
|---------------------------------------------|---------------------------------|---------|------------------------------|---------|-----------------------------------------------|--------|
| | Mean | Median | Mean | Median | Mean | Median |
| Former CEO | | | | | | |
| Tenure | 10.98 | 9.55 | 9.32 | 6.78 | 0.128 | <.0001 |
| Founder of firm | 39.29% | | 26.96% | | 0.091 | |
| Age at turnover of successor | 60.79 | 63 | 61.85 | 64 | 0.395 | 0.515 |
| Chairman of BOD at turnover of successor | 82.14% | | 41.40% | | <.0001 | |
| Share ownership at retirement | 6.54% | 1.04% | 4.24% | 0.92% | 0.176 | <.0001 |
| Annualized market- adjusted return | 9.15% | 6.32% | -3.85% | -1.92% | 0.001 | <.0001 |
| Annualized industry- adjusted return | 9.23% | 6.28% | -3.62% | -0.17% | 0.002 | <.0001 |
| Current CEO | | | | | | |
| Age at appointment | 49.36 | 50 | 53.16 | 53 | 0.000 | 0.016 |
| Tenure | 1.79 | 1.58 | 2.86 | 2.08 | <.0001 | <.0001 |
| Internal hire | 75.00% | | 67.81% | | 0.279 | |
| Annualized market- adjusted return | -23.98% | -24.00% | -13.63% | -13.26% | 0.064 | <.0001 |
| Annualized industry- adjusted return | -25.56% | -26.61% | -13.30% | -10.17% | 0.029 | <.0001 |
| Firm Characteristics | | | | | | |
| Assets | 5069.41 | 618.99 | 3019.55 | 600.08 | 0.194 | 0.068 |
| Tobin's Q | 2.54 | 1.79 | 2.09 | 1.59 | 0.062 | <.0001 |
| Sales growth | 0.28 | 0.22 | 0.19 | 0.13 | 0.037 | 0.000 |
| Capex / assets | 0.06 | 0.05 | 0.07 | 0.05 | 0.683 | 0.916 |
| Net PPE / assets | 0.25 | 0.22 | 0.28 | 0.20 | 0.328 | 0.131 |

Table 9: Determinants of the Decision to Rehire the Former CEO

The Table reports results from a two-stage Heckman selection model. The first stage estimates the determinants of the decision to retain the former CEO on the board of directors until the turnover of his successor. It is estimated for the entire sample. The results, for completeness, are reported in the column ‘selection equation’. We report the marginal effects for the probability of former CEOs remaining on the board of directors. The second stage models the probability that the former CEO returns to the position of CEO, given that we observe a data point in which the former CEO is a board member at the turnover of his successor. We report the conditional marginal effects for the probability of a former CEO being rehired given that the former CEO was a board member at the turnover of the current CEO. The accounting variables used in the second (first) stage regressions are measured at the turnover of current (former) CEO. The Wald test of independence is a chi-square test of independence of the principal and selection equations. All independent variables are described in Appendix A or Section 3. Standard errors are reported in parentheses. Statistical significance at the 1%, 5%, and 10% level is indicated by ***, **, and *, respectively.

| Selection Equation | | Principal Equation | |
|----------------------------------------------------------------------------------------|----------------------|-------------------------------------------------|---------------------|
| ROA | 0.255* (0.140) | Former CEO years in retirement | -0.025** (0.013) |
| Former CEO annualized Stock performance | 0.141*** (0.047) | Former CEO top quarter Performer | 0.074 (0.063) |
| Former CEO tenure | 0.006** (0.003) | Former CEO founder | -0.001 (0.053) |
| Former CEO stock ownership when retired | 0.746*** (0.290) | Former CEO chairman of board at the turnover | 0.169*** (0.038) |
| Former CEO founder | 0.118* (0.066) | Current CEO bottom quartile Performer | 0.091* (0.048) |
| Current CEO was internal Appointment | 0.001 (0.042) | Current CEO was internal Appointment | 0.057 (0.048) |
| Successor CEO age at Appointment | -0.008*** (0.002) | Net PPE / Assets | -0.057 (0.163) |
| Log(Assets) | -0.040*** (0.011) | Capex / Assets | -0.091 (0.604) |
| | | R&D / Sales | -0.087 (0.058) |
| Wald test of independence of selection equation and principal equation (p-value) | 0.062* | Log(Assets) | 0.036** (0.017) |
| | | High-tech industry indicator | 0.047 (0.063) |