

**Do CEOs Slow Down When Getting ‘Passed the Baton’?
Agency Costs of CEO Succession-Securing Behavior**

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Abstract

In the ‘passing the baton’ succession process, the incumbent CEO/Chairman relinquishes the CEO title, but retains the Chairman title to facilitate monitoring the new CEO during a probationary period. The new CEO eventually wins the Chairman title if he is successful during the probationary period. We argue that this type of succession process can lead to managerial conformism and conservatism because reputation concerns give the retiring CEO incentives to pressure the new CEO to continue existing policies and to avoid making major changes that could substantially improve performance or increase firm value. Consistent with this hypothesis, we find no changes in operating performance, abnormal stock returns, or the number of policy decisions the new CEO makes during his probationary period, but significant increases in all of these measures after the probationary period ends. Managerial entrenchment exacerbates succession-securing behavior during the probationary period, while effective monitoring and control mitigate it.

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1. Introduction

Recent corporate events have focused attention on a fundamental question in corporate governance research: How effective are boards of directors in monitoring the activities of CEOs? Determining the costs and benefits of separating the titles of Chief Executive Officer (CEO) and Chairman of the Board is a central issue in answering this question. Proponents of dual leadership (i.e., having separate individuals hold the two titles) have argued that unitary leadership (i.e., having one individual hold both titles) amounts to the CEO “grading his own homework¹”. Dual leadership is presumed better because the CEO has an independent monitor in the Chairman.

Brickley, Coles and Jarrell (1997) argue that there are costs to dual leadership and that its benefits are overstated since most firms with dual leadership are simply transitioning to unitary leadership. In this transition process, the incumbent CEO/Chairman relinquishes the CEO title to an heir apparent, but retains the Chairman title to help monitor the new CEO during a probationary period and pass along relevant information. Good-performing CEOs eventually obtain combined CEO/Chairman titles. With the former CEO as Chairman ready to step in if necessary, it is easier to terminate new CEOs who perform poorly. Vancil (1987) terms this succession process, common in U.S. firms, “passing the baton.”

¹ Brickley, Coles and Jarrell (1997) note that this schoolwork reference is attributable to Blenyth Jenkins, the director of Corporate Affairs for a London based trade group, who was quoted: “One of the major functions of the board is to supervise management. If the Chairman of the Board is also in management, then he is in effect making his own exam papers.” (“Balancing the power at the top. British Style” by Richard Stevenson, New York Times, Sunday, November 15, 1992)

We argue that the common succession process of passing-the-baton can create agency problems stemming from the retiring CEO's incentives. Brickley, Linck and Coles (1999) argue that the prospect of serving on other firms' boards of directors provides a promotion-like incentive for retiring CEOs, and find that the likelihood of obtaining such post-retirement positions depends on the retiring CEO's past performance. To increase the likelihood that outsiders view his past performance positively, a retiring CEO that remains as Chairman during a new CEO's probationary period has incentives to encourage his successor to continue his policies and projects. Continuing existing policies and projects makes it appear that those decisions were good even if they were bad ex ante or ex post based on the new CEO's information. The retiring CEO should also have incentives to discourage his successor from making major policy changes that could increase the operating performance and value of the firm substantially because this would signal to outsiders that the retiring CEO's policies did not maximize firm value. We call these incentives by the retiring CEO to make his successor conform "succession-securing behavior". Succession-securing behavior is costly for firms that need to change the retiring CEO's policies to maximize shareholder wealth.

The test-like nature of the succession process, with the retiring CEO as Chairman of the Board monitoring and evaluating the new CEO's performance, simultaneously provides incentives for the new CEO to curry favor with the old CEO. Since the new CEO understands the incentives the retiring CEO has, he has incentives to maintain the retiring CEO's policies and projects and to avoid substantial increases in operating performance or firm value as long as the retiring CEO is still Chairman.

Agency problems stemming from succession-securing behavior end when the new CEO obtains both titles and the retired CEO steps down from the chairmanship. Thus, if succession-securing behavior negatively affects CEO decision-making activity and firm performance, we should observe non-positive changes in these areas while the new CEO is monitored by the retired CEO as Chairman, but improvements in these areas once the probationary period ends. We also expect that the retiring CEO's ability and incentive to engage in succession-securing behavior is higher if he is entrenched, leading to longer probationary periods with more conformism imposed. Conversely, external monitoring mechanisms like outside board members and institutional blockholders should reduce the severity of succession-securing behavior by 'monitoring the monitor', leading to shorter probationary periods with less conformism imposed. Additionally, share ownership by the retiring CEO should decrease succession-securing behavior because his interests are more aligned with those of shareholders.

We test our hypotheses about succession-securing behavior on a sample of 203 firms that announce probationary-type CEO succession processes between 1993 and 1995. Consistent with the presence of succession-securing behavior, we find non-positive changes in the number of policy decisions the new CEO makes, operating performance, and abnormal stock returns. In contrast, we find significant increases in these measures after the probationary period ends. In firms where the retiring CEO has longer tenure and/or is a member of the founding family, probationary periods are longer and it is less likely that the new CEO makes more policy decisions or improves performance. These results suggest that succession-securing behavior is exacerbated by managerial entrenchment. Firms with high institutional ownership, firms with high

fractions of outside board members, and firms where board members have high equity ownership have shorter probationary periods and the difference in performance from the probationary period to the post-probationary period is smaller. These results suggest that effective monitoring can mitigate the negative effects of succession-securing behavior.

Our results shed new light on the agency costs of a common succession process. Collectively, the extant literature produces ambiguous conclusions about the superiority of unitary versus dual leadership. Since the passing-the-baton process involves temporary dual leadership, our evidence of succession-securing behavior suggests another cost of the dual leadership structure.

Our work is related to Naveen (2000), who documents that the tenure of the heir apparent and the time between the appointment of the heir apparent as COO or President and his subsequent appointment as CEO are longer in firms with passing-the-baton-type succession processes. She also finds abnormal returns at the announcement of CEO turnover to be lower for firms with relay-type planned succession processes. Naveen concludes that these results imply greater information transfer needs. Her results are also consistent, however, with the type of succession-securing behavior we document in this paper.

Section 2 develops arguments for the existence of succession-securing behavior and presents develop specific hypotheses. Section 3 presents the data and the methodology, followed by the results in Section 4. Section 5 concludes.

2. CEO Succession Processes and Potential Agency Costs

We use the term *dual leadership* to indicate structures in which two different people hold the CEO and Chairman of the board titles, and *unitary leadership* to indicate

structures in which one person holds both titles. Proponents of dual leadership argue that unitary leadership results in the CEO 'grading his own homework,' and thus increases managerial discretion by decreasing the monitoring effectiveness of the board of directors. Fama and Jensen (1983) argue that agency costs can be reduced by institutional arrangements that separate decision management from decision control, where these terms respectively refer to the right to initiate and implement resource allocation decisions and the right to ratify and monitor the implementation of these decisions. Dual leadership is a means to achieve such institutional decision control mechanisms.

Some empirical studies suggest that dual leadership is superior to unitary leadership. Pi and Timme (1993) examine a sample of 112 banks and find that costs are lower and return on assets is higher for banks with separate CEO and Chairman titles. Rechner and Dalton (1991) examine 141 firms over a six-year period and find that firms with dual leadership outperform firms with unitary leadership. Baliga, Moyer, and Rao (1996) analyze 181 industrial firms and find firms that switched to dual leadership had better long-term performance than firms that maintained unitary leadership.

Contrasting with these studies, Brickley, Coles, and Jarrell (1997) argue that there are costs associated with dual leadership that make it unclear that it is theoretically a superior leadership structure. These costs include the agency costs of monitoring the non-CEO chairman, costs associated with the costly and incomplete transfer of critical strategic information between the CEO and the Chairman, and disruption costs of the CEO succession process itself. Moreover, their empirical analysis suggests that the frequency of dual leadership and the benefits associated with it are overstated.

Specifically, they find that while about 14% of their sample firms have dual leadership, most firms are simply transitioning to unitary leadership with new CEOs; for these firms, dual leadership exists only over the probationary period.

Vancil (1987) terms the process of using a dual leadership structure to transition to a unitary leadership structure as *passing the baton*. Specifically, the passing-the-baton process involves the retiring CEO/Chairman relinquishing the CEO title to the heir apparent, i.e., passing the baton, but retaining the Chairman of the board title to better monitor the new CEO and to pass down any relevant information to him during a probationary period. In essence, the retiring CEO helps the board put his successor to a test, and if and when the new CEO passes the test, he is awarded the combined title of CEO/Chairman. Vancil argues that this probationary period with separate titles is structured to readily oust the new CEO if he fails the test.

Brickley, Coles and Jarrell's (1997) evidence is consistent with the hypothesis that the dual leadership structure is chosen to facilitate the monitoring of new CEOs who have greater need to be monitored by former CEOs who have incentive and ability to monitor them. Specifically, they find that dual leadership firms have younger CEOs with shorter tenure who own less stock and receive lower compensation levels than CEO/Chairman in unitary leadership firms. By contrast, most of the Chairmen in dual leadership firms are former CEOs or other people with detailed knowledge of the firm and relatively high stock ownership. Consistent with firms choosing an optimal leadership structure, Brickley, Coles, and Jarrell also find that firms choose dual leadership only when information and agency costs of dual leadership are low. They conclude that the passing-the-baton succession process is a prevalent strategy and is the

main reason for the existence of dual leadership in most firms. In contrast to previous empirical studies, Brickley, Coles and Jarrell (1997) also find no evidence that unitary leadership structures lead to inferior accounting or marketing returns.

Given Brickley, Coles, and Jarrell's (1997) evidence suggesting that the passing-the-baton process is prevalent and is a primary reason for observed dual leadership structures in US firms, it is important to have a deeper understanding of the costs and benefits of this process. In this paper, we focus on possible agency costs associated with the passing-the-baton process. We argue that the retiring CEO, as Chairman of the Board and monitor of the new CEO, could have incentives to impose managerial conformism and conservativeness on the new CEO. We call this succession-securing behavior.

Retiring CEOs have a reputation incentive to ensure that their past performance is viewed positively by outsiders who may wish to retain them for board seats or other positions. Consistent with this reputation incentive, Brickley, Linck, and Coles (1999) find a positive relation between post-retirement board service and performance for retiring CEOs. A retiring CEO's skill and decision-making ability would appear relatively inferior if a new CEO came in and reversed or undid the retired CEO's prior decisions. Additionally, a retiring CEO's performance would appear relatively inferior if a new CEO came in and substantially improved firm operating performance or stock returns.

These reputation concerns give a retiring CEO in a passing-the-baton succession process, incentives to encourage his successor to continue his projects and policies to imply or certify that they were good decisions. The retiring CEO also has incentives to discourage his successor from making major policy changes that would imply that his

past decisions were poor or that would substantially improve firm performance. These incentives may also cause the retiring CEO as Chairman to be reluctant to pass down relevant information that would position his successor to reverse or undo his prior decisions. This would increase information costs as described by Brickley, Coles and Jarrell. These incentives may also cause the retiring CEO as Chairman to try to block some of the new CEO's decisions by lobbying against him in the Board. Even if the former CEO does not perceive his reputation at stake, he is likely to believe in the real merit of his policies and decisions, and thus work to ensure his successor follows and even improves upon them, believing naively perhaps that they are in the best interests of the firm.

Vancil (1987) describes the position of the new CEO as follows: "The new CEO may also feel some pain [during the transition period]. He is ready to get on with his own tenure and may feel constrained about proposing new initiatives or disposing of past mistakes while his predecessor, who is responsible for those sins, is still in the room and practically running the meeting." Aside from such awkward feelings, the new CEO has incentives to curry favor with the retired CEO because as Chairman the retired CEO carries much weight in whether the new CEO is ultimately awarded the Chairman title. Thus, both the new CEO and the retiring CEO have incentives to engage in succession-securing behavior.

An anecdote from Vancil (1987) illustrates the type of problems we examine in this paper. Mr. Ben Branch, the CEO of Dow Chemicals from 1971 to 1976, made Dow Europe the center of corporate policy during his tenure and the hallmark of his career. When Mr. Branch decided to step down from the CEO position, he influenced the board

to vote for Mr. Zoltan Merszei as his successor because Mr. Merszei was then president of Dow Europe. The management team was reluctant about this appointment. During the next two years, Mr. Branch as Chairman of the Board tried to ensure that the European growth project received the highest priority in the firm's agenda, and worked to keep Mr. Merszei in position to run it while he tried to resolve frictions that arose within the top management and the board. When it became obvious that Mr. Merszei could not hold the CEO position any longer, Mr. Branch resigned from the Chairman position and Mr Merszei resigned from the CEO position. This illustrates a case where the retired CEO as Chairman chose a successor who had incentive to follow his policies and projects, and then worked to ensure those decisions were maintained, even though the decisions did not appear to maximize shareholder wealth. Moreover, even after it became clear that frictions prevented the new CEO from being an effective leader, the retired CEO tried to keep the new CEO in place to ensure his prior decisions would be continued.

The above discussion implies that succession-securing behavior in the passing-the-baton process could have negative effects on new CEO decision-making activity and on firm operating and stock performance. Thus, we develop the following specific hypotheses. First, since the succession-securing behavior occurs during the probationary period, we should see nonpositive changes in the number of CEO policy decisions, and in operating and stock performance when the CEO title passes from the CEO/Chairman to the new CEO, but the retired CEO still has the Chairman title. After the retired CEO steps down as Chairman and the new CEO obtains both titles, i.e., following the probationary period, the retired CEO/Chairman cannot enforce succession-securing

behavior. If succession-securing behavior restrains the new CEO from making policy changes and from improving operating and stock performance during the probationary period, then we should see improvements on these dimensions following the probationary period.

Second, the negative effects of succession-securing behavior should be worse the more entrenched the retiring CEO is. For example, if the former CEO is the founder of the firm or a member of the founding family, and he is handing the CEO title to an out-of-the family person, then he should have greater incentives to try to ensure that his successor follows the policies maintained by the founding family for years and represented by the retiring CEO. Similarly, the longer the former CEO has been in office, the greater would be his attachment to the projects he started or the policies he implemented. A more entrenched CEO, whether a member of the founding family or with long tenure, would also have closer relationships with board members and thus a greater influence on them, increasing the chances of influencing the new CEO while decreasing the monitoring effectiveness of the board. Thus, we expect the severity of succession-securing behavior to be greater for more entrenched CEOs. Specifically, we expect longer probationary periods and larger increases in performance and decision-making after the probationary period ends if an entrenched former CEO as Chairman is monitoring the new CEO.

Third, effective monitoring by the board of directors and by outside investors should decrease the severity of succession-securing behavior. Thus, we expect shorter probationary periods and less severe succession-securing behavior (as measured by changes in policy decisions and performance after the probationary period ends) for firms

with higher proportions of outside board members, firms with boards with relatively high stockholdings, and firms with high institutional stock ownership. Perry (1999) documents that stock-based compensation for outside directors increases the likelihood of CEO turnover and improves the monitoring quality of the board in general by aligning the interests of the directors with those of the shareholders. Additionally, if the retired CEO still owns options, then his interests should be more aligned with those of the shareholders, decreasing succession-securing behavior.

3. Sample and Methods

The sample includes all firms that announced a change to their CEO or Chairman of the Board positions in 1993 or 1995. We use data from 1993 to 1995 to allow for a period of at least three years after the new CEO is granted both titles and sufficient time has passed for him to implement his policies and for changes in operating performance to occur. Gabarro (1987) finds that three years is the typical time period over which new executives introduce major changes to their organization². We generated a gross sample using a keyword search on Lexis-Nexis of the major news and wire sources for articles containing the words ‘CEO’, ‘Chief Executive Officer’ or ‘Chairman’ and verbs such as ‘change’, ‘choose’, ‘appoint’, ‘name’, ‘select’, ‘retire’, ‘resign’, ‘elect’ or ‘leave’³. We classify firms as dual leadership if they change either their CEO or Chairman or both, and unitary leadership if they change their Chairman/CEO.

² Khurana and Nohria (2001) also follow this methodology and use three year periods.

³ Brickley, Coles and Jarrell (1997) is the first to use such a methodology. They search for Wall Street Journal announcements containing the words ‘chief executive officer’ and ‘chairman’ and the verbs ‘choose, appoint, name or select’. The methodology utilized in this paper improves upon their methodology. This proves to be a more comprehensive sample than just using the 800-1000 firms in the Forbes Executive Surveys like most of the previous literature.

We focus on firms that change from unitary to dual leadership and vice versa. Of the firms that change from unitary to dual leadership and vice versa, we retain those that appear to follow a planned relay-type succession plan. This yields a sample of 2,154 announcements by 1,923 firms. After excluding the announcements made by foreign or private firms and subsidiaries that do not trade separately, we have a sample of 1,339 announcements by 1,295 firms.

We verify the events and their dates by their appearance in the *Wall Street Journal*, and assume the event day to be the first day any news of the managerial change appears in the *Wall Street Journal* or any other major news wire or source. From the remaining 1,339 announcements, we remove the 44 announcements made about CEO or chairman changes around reorganizations, bankruptcies or going private transactions where public information is not available. Of the remaining 1,293 managerial changes, 527 (40.76 %) are passing-the-baton type probationary succession processes.

We trace the succession process of every firm using news articles in Lexis-Nexis and the *Wall Street Journal Corporate Index*, as well as managerial and board membership changes stated in proxy statements. We record the dates on which the CEO or Chairman titles change hands. Following Naveen (2000), we classify all CEO departures as forced departures if they are reported in the financial press as such. Additionally, we classify departures as forced if any CEO under the age of 60 leaves for reasons other than death, health, family matters or acceptance of any position within or outside the firm.

Interim office holders are not included in the sample. If an interim CEO becomes the permanent office holder, however, the probationary period is adjusted to include his

interim period as well. Subsidiaries are excluded because most of the time it is impossible to obtain market-based information on subsidiaries.

We obtain information on the ages and tenure of the CEO and Chairman at the time they are appointed and when they retire from the news announcements (double-checked with proxy statements). We collect stock ownership of the CEO and the Board members and the existence and the percentage of outside Board members from proxy statements. Twenty CEOs out of 527 in our sample are ousted before they were granted the combined CEO/Chairman title. We analyze the 20 firms separately.

We search Lexis-Nexis news and wire sources for policy changes during the probationary period and after the new CEO gets the combined title. We begin with all news articles about a firm over the relevant period. We delete earnings announcements, financial reports and reviews of the firm by other institutions, including financial institutions and rating agencies. We use the remaining number of events as a proxy for the number of policy decisions.

Stock return data and accounting data are from the Center for Research on Security Prices (CRSP) and Research Insight (COMPUSTAT) databases respectively, while data on institutional ownership are from Compact Disclosure and proxy statements. The availability of proxy statements for the entire required period and availability of data on CRSP and Research Insight databases, our sample size to 203 firms.

We conduct our analysis in two parts. First, we test for the existence of succession-securing behavior by comparing the number of policy decisions, operating performance, and abnormal stock returns across three periods: the three-year period

before the succession starts, the probationary period, and the three-year period after the successful conclusion of the probationary period.

Accounting operating performance measures are return on assets (ROA) and industry adjusted returns on assets (IAROA), following Baliga et al (1996) and Brickley, Linck and Coles (1999).⁴ Return on assets is the average return on assets over these periods, calculated as the net income divided by average assets. Following Parrino (1997) and Naveen (2000), industry-adjusted return on assets have been defined as the average annual returns on assets net of the industry mean, where the industry is determined according to two-digit SIC codes.⁵ Unreported results also use the Barber and Lyon (1997) criteria to create matched samples of firms⁶.

Mean abnormal stock returns are the returns on the security reported by CRSP net of the returns on the CRSP value-weighted index, following Baliga et al (1996) and Brickley, Coles and Jarrell (1997), and industry adjusted mean abnormal returns are the mean abnormal returns net of the industry average mean abnormal returns for the corresponding period, using two-digit SIC codes to determine industry (Parrino, 1997).⁷ Similar to accounting performance, unreported results re-do the same analysis using Barber and Lyon (1997) matching criteria for robustness.

⁴ Other measures of operating performance, like return on capital following Brickley, Coles and Jarrell (1997), return on equity (ROE) and return on investment (ROI) have been considered. However, tests have revealed similar results with all three proxies, therefore only ROAs are reported.

⁵ The industry-adjusted operating performance and market reaction variables are also calculated using four-digit SIC codes and the results are similar. Therefore, to be consistent with previous literature, two-digit SIC code based results are reported.

⁶ Since the results from these matched samples are qualitatively the same as other methods, industry adjusted performance measures have been reported in the paper in order to be consistent with previous literature.

⁷ The results for mean abnormal returns are checked for robustness by substituting the CRSP equally-weighted index instead of the value-weighted index. The empirical results remain unchanged under different market proxies, therefore, consistent with previous literature, only the results using the value-weighted index are reported.

Following Baliga et al. (1996) and Brickley, Coles and Jarrell (1997), the mean abnormal stock return is the return on the security net of the CRSP value-weighted index and industry-adjusted mean abnormal returns is the mean abnormal return net of the industry average mean abnormal returns for the corresponding period, using two-digit SIC codes to determine industry (Parrino, 1997). Results are qualitatively similar using the CRSP equally-weighted index instead of the value-weighted index so we do not report them.

We then use logit regressions to test whether measures of board and external monitoring effectiveness affect the likelihood of succession-security behavior. We classify a firm as exhibiting succession-securing behavior if we find both a significant increase in the number of policy decisions and an increase in operating performance following the probationary period. We use OLS regressions to test whether board and external monitoring effectiveness measures affect the length of the probationary period and the severity of succession securing behavior, as measured by the increase in the number of policy decisions, the increase in the operating performance, and the increase in abnormal stock returns.

4. Empirical Findings

Table 1 presents summary statistics for key variables. The departing CEOs in our sample are on average (median) 60 (63) years old and have been employed an average (median) of 20 (17.5) years by their companies. The mean (median) tenure of the departing CEO and Chairman as chairman on the board is 8.6 (7) years while his mean (median) tenure as the CEO is 9.7 (8) years.

Upon departure, the old CEOs and chairmen have on average (median) 4.9 % (1.35%) share ownership in the company. More than 75 % of the departing chairmen in the probationary succession sample have less than 5% ownership in the company, and more than half have less than 1.5 %, making stock ownership an inadequate means to align the incentives of the departing chairmen with those of the shareholders. Similarly, 118 (58.13%) of the departing chairmen are 60 or older, in other words, close to retirement age, consistent with Vancil's (1987) description of the relay-race style succession process as mainly a planned smooth succession process.

The average (median) age of the incoming CEOs is 50 (50), and with an average (median) of 9.43 (4) years spent previously with the company. These incoming CEOs have previously served on the board of directors of the company on average (median) 3.68 (2) years. Though the average new CEO has 1.4 % share ownership in the company when he first assumes the CEO title, the median stock ownership of new CEOs is less than 1%. The low stock ownership by former CEOs makes it hard for agency problems to be solved by the classical entrepreneurial owner-manager model where the incentives of the owners and the managers can be aligned through stock ownership. Consistent with Brickley, Linck and Coles (1999), the biggest incentive for top-tier management in our sample seems to be the prospect of serving on the Boards of Directors of other firms (42.86 % of the former CEOs in our sample go to serve on other Boards after retirement).

Fifty five firms in our sample (27.09%) choose their new CEOs from managers of other firms while eight (3.94%) name either their chief consultant or one of the outside directors to be the new CEO and subsequently CEO and chairman of the board of directors. There are three main paths to inside succession, however. Out of the

remaining 140 firms that promote managers from within the firm to the CEO position, 111 (54.68 % of the entire sample, and 79.29% of the firms that prefer inside successors) promote their presidents and/or chief operating officers to the CEO office. Ten (4.93 % of the sample) new CEOs are previous heads, presidents or CEOs of the main subsidiaries of the firm, while 15 (7.39 %) are promoted from executive or senior vice presidents or CFOs. This pattern also fits Vancil's (1987) description of passing-the-baton type succession processes where the departing CEO and chairman chooses an heir apparent, usually the President or COO of the firm, and relinquishes his CEO title to him.

Most of the departing chairmen in our sample continue their professional careers after relinquishing managerial titles. Almost half of the departing chairmen, 87 (42.86 %) to be exact, continue to serve as directors on the boards of other companies after retirement. On the other hand, 18 (8.87 %) departing chairmen remain on the board of directors of their companies as chairmen emeriti, 70 (34.48%) remain to serve as directors on their own boards and 11 (5.42%) continue to be chairmen of the executive committee. Similarly, 4 (1.97%) departing chairmen continue to serve their companies as consultants. Of these departing CEOs, 41 (20.20%) are also founders of their firms or members of the founding family. Since most departing chairmen continue their careers on either their own board or on the boards of directors of other corporations, incentives for succession-securing behavior exist in the sample.

The average (median) market capitalization of the firms that prefer relay-race type probationary succession processes is \$1,586.14 million (\$127.53 million). The mean market capitalization is significantly greater than the median because of some large cap companies included in the sample. Some of the largest firms in this sub-sample are

Phillip-Morris with a market capitalization of \$44,183 million and General Motors with a market capitalization of \$21,202 million. The sample includes 106 firms listed on the New York Stock Exchange (NYSE), 88 firms listed on NASDAQ and five firms listed on the American Stock Exchange (AMEX). The average (median) number of directors that serve on the board of directors of firms choosing probationary succession processes is 9.29 (9). On average (median) 36.91 % (37.5%) of the directors are outsiders. Members of the board except for the departing and incoming CEO own on average (median) 6.72 % (2.91%) of the shares of the company. Similarly, institutional ownership in the companies that utilize relay-race type succession processes is 32.86 % (36.79 %) on average (median). The average (median) length of the probationary period when the old and new CEOs serve together as chairman of the board and CEO, respectively, is 2.46 (1.57) years.

According to Vancil (1987), one of the purposes of the probationary period is to enable the board to effectively oust any new CEOs that “drop-the-baton” or cannot perform satisfactorily. In our sample, 20 firms (9.85 %) oust their CEOs before the completion of the probationary period. Six succession processes (2.96%), on the other hand, are concluded with the death of the incumbent CEO/current chairman.

4.1 Does succession-securing behavior or managerial conformism exist?

Table 2 presents the operating performance of the firms in our sample during the time of the former CEO, during the probationary transition period and after the new CEO has obtained the Chairman title as well. The changes between each period have been measured. The sub-sample of 20 firms whose new CEOs have been ousted upon the

completion of the probationary period are analyzed separately. The results indicate that both the return on assets and the industry adjusted return on assets decline during the transition period. The decline for the sub-sample with successfully completed succession processes is 0.28 and 0.16 in terms of ROA and IAROA respectively, neither of which are statistically significant (t-statistics are -1.52 and -1.16 respectively). This decline is even steeper for the 'ousted' sub-sample, whose ROA and IAROA decline, though still not statistically significant, by 1.57 and 0.57, respectively, during the transition period.

The period after the new CEO receives the combined CEO/Chairman title is a different story, however. The ROA and IAROA increase by 1.68 (t-stat = 2.82) and 1.26 (t-stat = 2.91), respectively, both of which are statistically significant at the 1 % level of significance.

Similarly, Table 3 measures the operating performance of the firm using stock returns. A similar phenomenon is observed in this case as well. There is a decline in stock returns during the transition period compared to the period before the former CEO relinquishes his CEO title to remain only as the Chairman. This decline is not statistically significant for firms whose new CEOs complete the probationary period successfully and receive the combined title; however it is significant for our sample of ousted CEOs. Parallel to the findings in Table 2, mean abnormal stock returns display a sudden and statistically significant increase (an increase of 4.64 % unadjusted and 3.22 % adjusted for the industry with t-statistics of 5.99 and 3.79 respectively) after the new CEO gets the combined title CEO/Chairman.

Huson, Malatesta and Parrino (2001) provide evidence that accounting measures of performance relative to other firms decline before managerial turnover events yet

improve subsequently after the turnover. They also find that the turnover announcements are associated with significantly positive abnormal stock returns. Our evidence indicates that for firms with probationary succession processes, the positive effect associated with managerial turnover events are mainly due to the end of the transition period and the new CEO obtaining the combined title.

The dramatic increases in both operating performance and stock returns after the new CEO gets awarded both titles imply the existence of managerial conformism and conservatism. These results are consistent with Brickley, Linck and Coles (1999), since the after retirement job prospects of former CEOs depend on their performance as a CEO, it is not surprising to not see any change in operating performance of these firms until after they leave the firm completely, and the new CEO is granted combined titles. These results are also consistent with Baliga et al (1996) and Brickley, Coles and Jarrell (1997) that report that firms that switch to dual leadership tend to perform worse than firms that stay with unitary leadership. The agency costs related to possible conformism during the succession process is one possible explanation for this phenomenon.

Table 4 attempts to provide a more direct test of the existence of succession-securing behavior or voluntary conformism in this passing-the-baton type probationary period based CEO succession process. It analyzes the number of major policy decisions made by the firm during the time of the former CEO, during the transition period and after the new CEO obtains both titles. The results presented in this table clearly indicate a significant decrease in the number of policy decisions made during the transition period for both the successful and the 'ousted' samples. The median number of policy decisions shows the same pattern with a median decrease in the number of policy decisions from 9

to 8 with a Wilcoxon rank-sum z-statistic of 2.47 (p-value=0.0127). After the transition period is over and the new CEO gets awarded the combined CEO/Chairman title, however, there is a statistically significant increase in both the mean and the median number of policy decisions. (with t-statistics and Wilcoxon z-statistics of 8.26 and 3.08, respectively), of almost the same amount as the initial decrease at the beginning of the probationary period.

The insignificant change in operating performance during the probationary period coupled with the decrease in the number of policy decisions is consistent with our hypothesis that there is succession securing or conformist behavior during the transition process. This makes the conflicts of interest apparent between the incumbent and the new CEOs.

Table 5 shows examples of some of the major policy decisions made by these firms.

4.2. What factors affect the level of managerial conformism and probability of succession-securing behavior?

The length of the probationary period can serve as a proxy for the severity of the agency costs between the incumbent and the new CEOs in this passing-the-baton type of succession processes, since the more the incumbent CEO tries to secure the continuation of his policies, the longer it would take for the new CEO to pass the test, and be awarded the combined title of CEO and Chairman of the Board. Therefore, Table 6 presents regression results of the length of the transition period on factors that exacerbate or mitigate the tendency for succession-securing behavior during the probationary period. CEOs of small and young firms, or firms in high-growth industries are harder to monitor in general, therefore firm size (measured as the natural logarithm of market value of the

firm), age of the firm and market-to-book ratio as a measure of growth opportunities are used as control variables in the regressions. Consistent with these predictions, both log size and firm age are significantly negatively related to the length of the transition period in all eight models. In other words, the smaller and the younger the firm, the longer it takes the new CEO to obtain the combined title, suggesting that smaller and younger firms have higher agency costs in the probationary succession process. This may be due to the fact that older and bigger firms have established rules of succession that have been working over the years and the succession process becomes part of the corporate culture, decreasing the conflicts of interest.

Former CEO tenure and the dummy variable that equals one if the former CEO is either the founder of the firm or a member of the founding family, both have significantly positive effects, with coefficients (t-statistics) equaling 0.63 (2.27) and 2.09 (3.25) respectively, on the length of the transition period. In other words, the longer the former CEO has held the position of CEO/Chairman, the longer it takes for the new CEO to be granted the same combined title. Similarly, if the former CEO/Chairman is the founder of the firm or a member of the founding family, the probationary period gets longer. We use both former CEO tenure and Founder dummy as proxies for managerial entrenchment, and consistent with expectations, managerial entrenchment increases the agency costs involved in the CEO succession process.

An important point to note here is that younger firms are more likely to have their founders or members of the founding family as managers, and the 10 smallest firms in our sample all have their entrepreneurs leaving the firm to professional managers as a

part of their planned succession process. This provides another explanation as to why younger and smaller firms are more likely to have longer probationary periods.

Furthermore, the age of the departing CEO has a marginally significant positive effect (with a coefficient of 0.87 and a t-stat of 1.72) on the length of the probationary period. This is consistent with our expectations, since older CEOs have fewer career alternatives after retirement, they are more likely to value their own reputation that depends on the prior performance of the firm.

CEO stock ownership aligns the interests of the former CEO with those of the shareholders, providing a classical solution to the agency problem present in CEO successions. The coefficient of departing CEO stock ownership is negative in Table 6, consistent with this expectation, however, the coefficient is not significant.

Institutional ownership, share ownership by the directors on the board and the percentage of outside Board members all have significantly negative coefficients (-0.11 ($t = -2.07$), -0.66 ($t = -2.64$) and -0.79 ($t = -2.04$), respectively), implying that the effectiveness of outside monitoring dramatically reduces agency costs. These results serve to answer the Alchian and Demsetz (1972) question of “who monitors the monitor?” While stock ownership by managers does not seem to solve the problem, outside monitoring either by institutional investors or outside board members, mitigates the agency costs.

When all variables are included in the regressions, only CEO tenure, founder dummy, the percentage of outside board members and their share holdings remain as significant determinants of the length of the probationary period. This implies that including outside directors, that are not too familiar with the corporate culture, on the

firm's board and providing them with stock based compensation to align their interests with those of the shareholders is the most influential monitoring mechanism on top-tier management.

Table 7 presents the results of logit regressions where the dependent variable takes the value of one if the number of policy changes after the new CEO gets the combined title are higher and if the operating performance of the firm improves upon the end of the transition period. These results do not vary significantly from those of Table 6. The main difference is that departing CEO age, institutional ownership and percentage of outside board members are not significant anymore. Share ownership of directors other than CEO and the Chairman still has negative significant effects. Yet the main results remain unchanged. Larger firm size, firm age and better outside monitoring decrease the probability of succession-securing behavior, while managerial entrenchment seems to increase this probability.

In Tables 8, we regress the increase in the accounting performance of the firm after the probationary period is over and the new CEO obtains the combined title on the same factors. The results are similar. Smaller and younger firms experience greater increases in accounting performance when the new CEO obtains the combined title. The older the departing CEO and the longer he has been in the CEO office, the higher the increase in operating performance. On the other hand, increased institutional ownership and board member stock ownership and higher percentage of outside members on the Board lead to smaller increases in accounting performance after the probationary period is over. One interesting result in this table is that the founder dummy is no longer significant. This might be due to two factors: First of all some of the founders in our

sample just pass the baton to other members of the family that lead to no significant changes in management, and second even if the founder retires, his presence may still be felt in these companies, increasing the scope of conformism beyond the transition period.

Table 9 and 10 present similar results for changes in stock performance and increases in the number of policy decisions made by the firm after the new CEO gets the combined title. The results are very similar.

The empirical findings presented in this section indicate that there are significant agency costs between the former CEO and the new CEO. The agency costs inherent in this probationary type succession processes are exacerbated by managerial entrenchment while they are mitigated by outside monitoring.

5. Conclusion

We analyze the prevalent CEO succession process in US firms, termed ‘passing the baton’ in which the incumbent CEO/Chairman of the Board relinquishes the CEO title to his heir apparent but remains as Chairman of the Board for a probationary period to better monitor the new CEO and pass down any relevant information. At the end of this probationary period, the new CEO is awarded the combined title of CEO and Chairman of the Board if he is successful, or is terminated otherwise.

While the benefits of this succession system have been analyzed thoroughly in finance literature, the conflicts of interest between the former and the new CEOs inherent in this process due to the incentives of the incumbent CEO to ensure the continuation of his policies and visions for the firm as well as protecting his own performance from depreciating in value, have received little attention. The retiring CEO has promotional

incentives of serving on other firms' Boards based on his past performance, increasing his incentives to engage in succession-securing behavior.

The results indicate the existence of agency costs in the succession process due to this managerial conformism. Managerial entrenchment seems to exacerbate these problems, while the monitoring effectiveness of the Board of Directors and external monitoring mechanisms such as external Board members and institutional blockholders reduce these agency costs and the probability of managerial conformism.

This paper revisits the Alchian and Demsetz (1972) question of "who monitors the monitor?" and presents yet another source of conflicts within top management of the modern firm. Additionally, with contemporary corporate events that have called to attention the effectiveness of both external and internal control mechanisms of firms, our results bear significant value.

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Table 1
Probationary Succession Processes

Panel A presents the descriptive statistics of the passing the baton sample. CEO ages, prior time spent in the firm and the departing CEO tenure as CEO are all measured in terms of years. Departing CEO and chairman share ownership and institutional ownership measure the percentage of the firm's stock owned by the incumbent CEO and by institutional investors, respectively. Board Stock ownership measures the percentage of the firm's shares owned by Board members except the departing and/or incoming CEO and the Chairman of the Board. Probationary period is the number of years it takes for new CEO to be granted the combined CEO/Chairman of the Board title, during which the old and the new CEO work together. Board size is the number of directors that serve on the board of the firm. The percentage of outside board members measures the proportion of directors on the Board of the firm that are not former employees of the firm and have no business relationships with the firm. Market capitalization of the firms is also presented in millions of dollars. Panel B presents the percentage of firms in the sample with incomplete probationary succession processes where the new CEO was ousted before he was granted the combined title or where the heir apparent left the firm before becoming the CEO as well as the exchanges the firms are listed on. Panels C and D present the origins of incoming CEOs and the future career choices of departing chairmen/CEOs, respectively.

Panel A: Descriptive Statistics

Variable	N	Mean	Std Dev	Min	25%	Median	75%	Max
Departing CEO and Chairman Age	203	60.46	8.27	35	56	63	65	78
Departing CEO and Chairman Tenure as Chairman	203	8.63	7.98	0.25	3	7	11	47
Departing CEO and Chairman Tenure as CEO	203	9.68	8.07	0.5	4	8	12	47
Departing CEO and Chairman Prior Time with the Firm	203	20.35	13.50	0.5	9	17.5	31.75	52
Departing CEO and Chairman Share Ownership (%)	203	4.91	9.81	<1	<1	1.35	4.23	62.1
Incoming CEO Age	203	50.09	6.96	34	45	50	55	67
Incoming CEO Prior Time with the Firm	203	9.34	10.93	0	0.29	4	15.5	40
Incoming CEO Prior Time as a director on the board	203	3.68	4.67	0	0	2	5	27
Incoming CEO Share Ownership (%)	203	1.43	3.67	0	<1	<1	1.4	26
Length of the Probationary Period	203	2.46	2.60	0.01	0.75	1.57	3.53	16.34
Board Size	203	9.29	3.26	3	7	9	11	23
Outside Board Members (%)	203	36.91	15.47	0	27.27	37.5	46.96	76.92
Institutional Ownership (%)	203	32.86	12.5395	0.31	12.73	36.79	52.12	87.24
Board Stock Ownership (%)	203	6.72	11.40	<1	<1	2.91	7.49	74.8
Market Capitalization (\$millions)	203	1586.14	5126	1.67	16.10	127.53	976.54	44183

Panel B: Succession Details

	Number	% of Sample
New CEOs ousted after transition period	20	9.85 %
Transition period ends with the death of the departing chairman	6	2.96 %
Departing chairmen that are founders or members of the founding family	41	20.20 %
Firm is listed on NYSE	106	52.22 %
Firm is listed on NASDAQ	88	43.35 %
Firm is listed on AMEX	5	2.46 %

Panel C: Incoming CEO Origin

	Number	% of Sample
Incoming CEO is an outsider	55	27.09 %
Incoming CEO was President or Chief Operating Officer	111	54.68 %
Incoming CEO was President or CEO of a subsidiary	10	4.93 %
Incoming CEO was Executive/Senior VP or CFO	15	7.39 %
Incoming CEO was outside director or consultant to the firm	8	3.94 %

Panel D: Departing CEO and Chairman's Future Career

	Number	% of Sample
Departing chairmen that serve on other boards after retirement	87	42.86 %
Departing chairman stays on the board as Chairman Emeritus	18	8.87 %
Departing chairman stays on the board as a director	70	34.48 %
Departing chairman stays on the board as chairman of the executive committee	11	5.42 %
Departing chairman stays on the board as a consultant to the firm	4	1.97 %

Table 2
Operating Performance

Operating performance is measured by Return on Assets (ROA) and Industry Adjusted ROA (IAROA). Former CEO refers to the last three years of the former CEO's tenure before the succession took place. Probationary period refers to the transition period when the former CEO/current Chairman worked together with the new CEO, and the combined period refers to the first three years of the new CEO's tenure after he obtains the combined CEO and Chairman of the Board title. Δ_F presents the mean difference between the ROA and the IAROA before the former CEO steps down and the transition period, and Δ_C refers to the mean difference in operating performance after the new CEO gets the combined title. ROA is calculated as the average return on assets over the respective periods, while the industry adjusted ROA is the average annual ROA net of industry mean, using two digit SIC codes to determine industry. Results for both the sample of successful successions and the ones where the new CEO is ousted before he can obtain the combined title are presented separately. Panel A presents the ROA, while Panel B presents the industry adjusted ROA. *, ** and *** represents significance at the 10%, 5% and 1% levels, respectively.

Panel A: Return on Assets

	Former CEO	Probationary Period	Combined Title	Δ_F	t-stat (p-value)	Δ_C	t-stat (p-value)
Successful (N = 183)	3.40	3.12	4.89	-0.28	-1.47 (0.1181)	1.68***	2.82 (0.0001)
Ousted (N = 20)	2.78	1.21		-1.57	-1.50 (0.1203)		

Panel B: Industry Adjusted Return on Assets

	Former CEO	Probationary Period	Combined Title	Δ_F	t-stat (p-value)	Δ_C	t-stat (p-value)
Successful (N = 183)	1.10	0.94	2.31	-0.16	-1.16 (0.1318)	1.37***	2.91 (0.0000)
Ousted (N = 20)	0.91	0.34		-0.57	-1.41 (0.1127)		

Table 3
Stock Returns

Former CEO refers to the last three years of the former CEO's tenure before the succession took place. Probationary period refers to the transition period when the former CEO/current Chairman worked together with the new CEO, and the combined period refers to the first three years of the new CEO's tenure after he obtains the combined CEO and Chairman of the Board title. Δ_F presents the mean difference between the mean abnormal stock returns before the former CEO steps down and the transition period, and Δ_C refers to the mean difference in stock return performance after the new CEO gets the combined title. Mean abnormal stock returns are the average abnormal stock returns during the respective periods, calculated as the mean difference between the stock returns of the firm and the returns on the CRSP value-weighted index. Industry adjusted mean abnormal returns are the average mean abnormal returns for these periods net of the industry average calculated using two-digit SIC codes. Results for both the sample of successful successions and the ones where the new CEO is ousted before he can obtain the combined title are presented separately. Panel A presents the mean abnormal returns, while Panel B presents the industry adjusted mean abnormal returns. *, ** and *** represents significance at the 10%, 5% and 1% levels, respectively.

Panel A: Mean Abnormal Returns

	Former CEO	Probationary Period	Combined Title	Δ_F	t-stat (p-value)	Δ_C	t-stat (p-value)
Successful (N = 183)	2.25 %	1.37 %	6.01 %	-0.88	-1.13 (0.1919)	4.64***	5.99 (0.0000)
Ousted (N = 20)	1.26 %	0.13 %		-1.13*	-1.70 (0.0869)		

Panel B: Industry Adjusted Mean Abnormal Returns

	Former CEO	Probationary Period	Combined Title	Δ_F	t-stat (p-value)	Δ_C	t-stat (p-value)
Successful (N = 183)	1.36 %	0.12 %	3.34 %	-1.24	-1.34 (0.1843)	3.22***	3.79 (0.0000)
Ousted (N = 20)	0.24 %	-0.93 %		-1.17**	-1.82 (0.0331)		

Table 4
Number of Policy Decisions

The number of policy decisions for each firm have been determined by counting the results of a keyword search on Lexis-Nexis news and wire sources. All newsworthy events by the company with the exception of routine announcements of earnings, financial report filings, have been included as policy decisions. Former CEO refers to the last three years of the former CEO's tenure before the succession took place. Probationary period refers to the transition period when the former CEO/current Chairman worked together with the new CEO, and the combined period refers to the first three years of the new CEO's tenure after he obtains the combined CEO and Chairman of the Board title. Δ_F presents the mean difference between the number of policy decisions before the former CEO steps down and the transition period, and Δ_C refers to the difference in the number of policy decisions between the probationary period and after the new CEO gets the combined title. Results for both the sample of successful successions and the ones where the new CEO is ousted before he can obtain the combined title are presented separately. Panel A presents the mean number of policy decisions, while Panel B presents the median. *, ** and *** represents significance at the 10%, 5% and 1% levels, respectively.

Panel A: Mean Number of Policy Decisions

	Former CEO	Probationary Period	Combined Title	Δ_F	t-stat (p-value)	Δ_C	t-stat (p-value)
Successful (N = 183)	8.33	6.95	9.38	-1.38***	-7.04 (0.0000)	2.53***	8.26 (0.0000)
Ousted (N = 20)	8.27	6.11		-2.16***	-4.98 (0.0000)		

Panel B: Median Number of Policy Decisions

	Former CEO	Probationary Period	Combined Title	Δ_F	Wilcoxon z-stat (p-value)	Δ_C	Wilcoxon z-stat (p-value)
Successful (N = 183)	10	9	11	-1**	-2.47 (0.0127)	2***	3.08 (0.0001)
Ousted (N = 20)	8.5	6		-2.5***	-3.19 (0.0000)		

Table 5
Examples of Policy Decisions

This table presents some examples of policy decisions included in the analysis. These are not the entire policy changes, but they are a representative sample. The number of firms that have a policy decision like this have been presented in the second column.

Policy Decisions	Number of Firms
Management Changes	203
Changes in Board Members	187
Changes in Board Size	19
Downsizing	12
Mergers and Acquisitions	21
New Product Lines	37
Major Productive Investments (New plant, product facility expansions...etc)	28
New Credit Lines	53
New Debt Issues	71
Seasoned Equity Issues	4
Dividend Policy Changes (Increases, Decreases or Omissions of Dividends)	28
Chapter 11 Filings	3
Asset Sales	5
Joint Venture Agreements	12
Divestitures	17

Table 6
Determinants of the Probability of Succession Securing Behavior

The results of a logit regression predicting the probability of succession securing behavior by the former CEO or conformism by the new CEO are presented. The dependent variable has been set equal to one if there is an increase in the number of policy decisions after the transition period is over and there is an improvement in the operating performance of the firm measured by both ROA and industry adjusted ROA, after the transition period is over. Log size is the natural logarithm of the market value of the firm, and market-to-book is the ratio of the market value of the firm to its book value. Firm age is the number of years since the establishment of the company until the start of the probationary period. Former CEO tenure measures the number of years the departing CEO has been holding the office of CEO prior to stepping down. Founder is a dummy variable that takes the value of one if the former CEO is the founder of the company or a member of the founding family. Institutional ownership, departing CEO ownership and Board of directors ownership represent the percentage of stock ownership by institutional investors, by the departing CEO and by the members of the board that are neither Chairman or CEO. Finally the percentage of outside board membership measures the ratio of the board members that are not former employees of the firm or have business relationships with the firm to the entire size of the Board of Directors. The 29 firms with incomplete succession processes have been excluded from the regressions. All errors are White-corrected for heteroskedasticity and t-statistics are presented in parentheses. *, ** and *** represent significance at the 10%, 5% and 1% levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	0.92 (0.84)	0.53 (0.58)	0.82 (1.01)	0.97 (1.10)	0.54 (0.88)	0.95 (1.04)	0.55 (0.71)	0.99 (1.11)
Log Size	-0.86** (-2.28)	-0.54** (-2.25)	-0.69** (-2.29)	-0.49** (-2.18)	-0.45** (-2.08)	-0.59** (-2.04)	-0.79** (-2.23)	-0.53** (-2.12)
Firm Age	-0.04* (-1.72)	-0.04* (-1.74)	-0.04* (-1.79)	-0.05* (-1.88)	-0.03* (-1.69)	-0.01 (-1.58)	-0.08** (-1.99)	-0.06* (-1.76)
Market-to-Book	0.003 (0.79)	0.005 (0.57)	0.004 (0.86)	0.007 (1.06)	0.005 (1.05)	0.004 (0.87)	0.001 (0.69)	0.003 (0.72)
Departing CEO Age	0.0071 (1.42)							0.0082 (1.54)
Departing CEO Tenure		0.103*** (2.79)						0.004 (1.42)
Founder			0.95*** (4.03)					0.89*** (3.28)
Institutional Ownership				-0.008 (-1.16)				-0.001 (-0.52)
Board Ownership					-0.006* (-1.92)			-0.005* (-1.83)
Departing CEO Ownership						-0.0042 (-1.29)		-0.002 (-1.08)
Outside Board Members							-0.01 (-1.15)	-0.003 (-0.89)
R ²	0.22	0.31	0.30	0.27	0.29	0.30	0.33	0.37
N	203	203	203	203	203	203	203	203

Table 7
Determinants of the Length of the Probationary Period

The dependent variable in the regression models is the length of the probationary period, in years, when the new CEO and the departing CEO/current Chairman work together. Log size is the natural logarithm of the market value of the firm, and market-to-book is the ratio of the market value of the firm to its book value. Firm age is the number of years since the establishment of the company until the start of the probationary period. Former CEO tenure measures the number of years the departing CEO has been holding the office of CEO prior to stepping down. Founder is a dummy variable that takes the value of one if the former CEO is the founder of the company or a member of the founding family. Institutional ownership, departing CEO ownership and Board of directors ownership represent the percentage of stock ownership by institutional investors, by the departing CEO and by the members of the board that are neither Chairman or CEO. Finally the percentage of outside board membership measures the ratio of the board members that are not former employees of the firm or have business relationships with the firm to the entire size of the Board of Directors. The 29 firms with incomplete succession processes have been excluded from the regressions. All errors are White-corrected for heteroskedasticity and t-statistics are presented in parentheses. *, ** and *** represent significance at the 10%, 5% and 1% levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	1.35 (0.71)	1.23 (0.56)	1.33 (0.74)	1.46 (0.80)	1.11 (0.77)	1.29 (0.68)	1.15 (0.47)	1.06 (0.53)
Log Size	-2.18** (-1.82)	-1.99** (-1.87)	-2.10** (-2.12)	-2.18** (-2.10)	-2.19** (-2.07)	-2.04** (-2.18)	-2.07*** (-2.00)	-2.28*** (-2.40)
Firm Age	-1.06* (-1.79)	-1.12** (-2.07)	-1.00* (-1.71)	-1.09* (-1.78)	-1.03* (-1.83)	-1.01* (-1.95)	-1.08* (-1.89)	-0.98* (-1.72)
Market-to-Book	0.001 (0.60)	0.020 (0.71)	-0.024 (-0.85)	0.002 (0.32)	-0.001 (-0.59)	-0.034 (-1.15)	0.027 (1.03)	0.029 (0.91)
Departing CEO Age	0.87* (1.72)							0.35 (1.26)
Departing CEO Tenure		0.63** (2.27)						0.74* (2.19)
Founder			2.09*** (3.25)					2.03*** (2.78)
Institutional Ownership				-0.11** (-2.07)				-0.013 (-1.25)
Board Ownership					-0.66*** (-2.64)			-0.36* (-1.94)
Departing CEO Ownership						-0.17 (-1.42)		-0.09 (-1.08)
Outside Board Members							-0.79** (-2.04)	-0.63* (-1.77)
R ²	0.05	0.05	0.07	0.04	0.06	0.03	0.07	0.08
N	203	203	203	203	203	203	203	203

Table 8
Determinants of the Increase in Operating Performance

The dependent variable in the regression models is the change in the operating performance (change in ROA) of the firm upon the conclusion of the probationary period when the new CEO takes on the combined CEO and Chairman of the Board title (i.e. Δ_C). Log size is the natural logarithm of the market value of the firm, and market-to-book is the ratio of the market value of the firm to its book value. Firm age is the number of years since the establishment of the company until the start of the probationary period. Former CEO tenure measures the number of years the departing CEO has been holding the office of CEO prior to stepping down. Founder is a dummy variable that takes the value of one if the former CEO is the founder of the company or a member of the founding family. Institutional ownership, departing CEO ownership and Board of directors ownership represent the percentage of stock ownership by institutional investors, by the departing CEO and by the members of the board that are neither Chairman or CEO. Finally the percentage of outside board membership measures the ratio of the board members that are not former employees of the firm or have business relationships with the firm to the entire size of the Board of Directors. The 29 firms with incomplete succession processes have been excluded from the regressions. All errors are White-corrected for heteroskedasticity and t-statistics are presented in parentheses. *, ** and *** represent significance at the 10%, 5% and 1% levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	1.29 (1.47)	0.97 (1.23)	1.31 (1.49)	1.14 (1.35)	1.13 (1.29)	1.24 (1.33)	1.26 (1.41)	1.03 (1.25)
Log Size	-1.55* (-1.73)	-1.47* (-1.70)	-1.73* (-1.81)	-1.58* (-1.77)	-1.61* (-1.74)	-1.64* (-1.75)	-1.52* (-1.72)	-1.46* (-1.70)
Firm Age	-0.03* (-1.86)	-0.01* (-1.79)	-0.04* (-1.89)	-0.03* (-1.84)	-0.02* (-1.81)	-0.06* (-1.92)	-0.05* (-1.90)	-0.04* (-1.91)
Market-to-Book	0.003 (0.36)	-0.002 (-0.18)	0.001 (0.27)	-0.004 (-0.41)	-0.008 (-0.74)	0.002 (0.19)	-0.003 (-0.34)	0.004 (0.46)
Departing CEO Age	1.64** (2.07)							1.06 (1.58)
Departing CEO Tenure		1.04** (2.16)						1.02** (2.07)
Founder			1.97 (1.53)					1.68 (1.41)
Institutional Ownership				-0.98** (-2.22)				-0.57 (-1.39)
Board Ownership					-1.32* (-1.97)			-1.05* (-1.74)
Departing CEO Ownership						-0.59 (-1.34)		-0.52 (-1.26)
Outside Board Members							-0.42** (-2.01)	-0.39* (-1.82)
R ²	0.04	0.05	0.03	0.05	0.06	0.04	0.05	0.09
N	203	203	203	203	203	203	203	203

Table 9
Determinants of the Increase in Abnormal Stock Returns

The dependent variable in the regression models is the change in the abnormal stock returns of the firm upon the conclusion of the probationary period when the new CEO takes on the combined CEO and Chairman of the Board title (i.e. Δ_C). Log size is the natural logarithm of the market value of the firm, and market-to-book is the ratio of the market value of the firm to its book value. Firm age is the number of years since the establishment of the company until the start of the probationary period. Former CEO tenure measures the number of years the departing CEO has been holding the office of CEO prior to stepping down. Founder is a dummy variable that takes the value of one if the former CEO is the founder of the company or a member of the founding family. Institutional ownership, departing CEO ownership and Board of directors ownership represent the percentage of stock ownership by institutional investors, by the departing CEO and by the members of the board that are neither Chairman or CEO. Finally the percentage of outside board membership measures the ratio of the board members that are not former employees of the firm or have business relationships with the firm to the entire size of the Board of Directors. The 29 firms with incomplete succession processes have been excluded from the regressions. All errors are White-corrected for heteroskedasticity and t-statistics are presented in parentheses. *, ** and *** represent significance at the 10%, 5% and 1% levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	0.36 (1.68)	0.65* (1.83)	0.51* (1.75)	0.57* (1.76)	0.67* (1.89)	0.74* (1.93)	0.49* (1.72)	0.43* (1.70)
Log Size	-0.73* (-1.89)	-0.89* (-1.94)	-0.62* (-1.71)	-0.86* (-1.92)	-0.87* (-1.93)	-0.78* (-1.91)	-0.65* (-1.76)	-0.75* (-1.88)
Firm Age	-0.04 (-1.57)	-0.05 (-1.63)	-0.05 (-1.62)	-0.03 (-1.49)	-0.04 (-1.58)	-0.02 (-1.37)	-0.03 (-1.44)	-0.06 (-1.62)
Market-to-Book	0.003 (0.38)	0.004 (0.45)	0.006 (0.59)	0.005 (0.51)	0.006 (0.61)	0.003 (0.40)	0.004 (0.42)	0.003 (0.39)
Departing CEO Age	0.0042* (1.71)							0.0037 (1.68)
Departing CEO Tenure		0.117** (2.04)						0.092* (1.71)
Founder			0.083 (1.42)					0.076 (1.35)
Institutional Ownership				-0.08* (-1.78)				-0.05 (-1.63)
Board Ownership					-0.073* (-1.81)			-0.062* (-1.72)
Departing CEO Ownership						-0.0026 (-1.25)		-0.0014 (-1.03)
Outside Board Members							-0.004* (-1.74)	-0.007* (-1.89)
R ²	0.02	0.03	0.02	0.04	0.03	0.02	0.05	0.07
N	203	203	203	203	203	203	203	203

Table 10
Determinants of the Increase in Number of Policy Decisions

The dependent variable in the regression models is the change in the number of policy decisions of the firm Upon the conclusion of the probationary period when the new CEO takes on the combined CEO and Chairman of the Board title (i.e. Δ_C). Log size is the natural logarithm of the market value of the firm, and market-to-book is the ratio of the market value of the firm to its book value. Firm age is the number of years since the establishment of the company until the start of the probationary period. Former CEO tenure measures the number of years the departing CEO has been holding the office of CEO prior to stepping down. Founder is a dummy variable that takes the value of one if the former CEO is the founder of the company or a member of the founding family. Institutional ownership, departing CEO ownership and Board of directors ownership represent the percentage of stock ownership by institutional investors, by the departing CEO and by the members of the board that are neither Chairman or CEO. Finally the percentage of outside board membership measures the ratio of the board members that are not former employees of the firm or have business relationships with the firm to the entire size of the Board of Directors. The 29 firms with incomplete succession processes have been excluded from the regressions. All errors are White-corrected for heteroskedasticity and t-statistics are presented in parentheses. *, ** and *** represent significance at the 10%, 5% and 1% levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	1.05 (0.72)	1.21 (1.05)	1.14 (0.93)	1.17 (0.95)	1.10 (0.84)	1.38 (1.13)	1.26 (1.07)	1.09 (0.81)
Log Size	-1.57* (-1.83)	-1.79** (-1.97)	-1.68* (-1.89)	-1.82** (-1.99)	-1.63* (-1.87)	-1.69* (-1.90)	-1.72* (-1.94)	-1.55* (-1.73)
Firm Age	-0.04* (-1.92)	-0.03* (-1.89)	-0.02* (-1.75)	-0.04* (-1.90)	-0.06* (-1.95)	-0.05* (-1.92)	-0.03* (-1.88)	-0.02* (-1.78)
Market-to-Book	0.003 (1.49)	0.005 (1.57)	0.004 (1.52)	0.002 (1.42)	0.006 (1.61)	0.004 (1.55)	0.005 (1.56)	0.002 (1.39)
Departing CEO Age	1.03** (2.37)							0.99* (1.76)
Departing CEO Tenure		1.29*** (3.12)						0.73** (2.15)
Founder			2.07* (1.72)					0.47 (1.52)
Institutional Ownership				-0.94** (-2.13)				-0.65* (-1.71)
Board Ownership					-1.12* (-1.73)			-0.34 (-1.06)
Departing CEO Ownership						-0.98 (-1.52)		-0.65 (-1.39)
Outside Board Members							-1.78*** (-2.45)	-1.72** (-2.14)
R ²	0.11	0.12	0.09	0.10	0.07	0.06	0.09	0.14
N	203	203	203	203	203	203	203	203