Powerful CEOs in uncertain times: survival of the fittest

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Motivation

How much power should the CEO have?

- Conventional views focus on the costs of excessive CEO power
  - Researchers: agency problem is a key part in the corporate governance literature
  - Regulators: passed rules to limit the power of CEO, e.g. Sarbanes-Oxley Act contains provisions that strengthen CEO monitoring

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  - Researchers: agency problem is a key part in the corporate governance literature
  - Regulators: passed rules to limit the power of CEO, e.g. Sarbanes-Oxley Act contains provisions that strengthen CEO monitoring
- However, on the other hand, uncertain times witness a rise in strong leadership
  - At the beginning of the COVID-19 pandemic,
    - Firms transformed from co-CEO to the sole CEO model
    - Long-tenured CEOs postponed their planned retirements
    - Once-distanced powerful leaders returned to day-to-day management

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- Measures used in this paper
  - CEO power: *CEO-chair duality*
    - Alternative measures: *# Titles*, *CEO tenure*, *Longer directorship*, and *Founder CEO*
  - Uncertainty: *Stock volatility* on the industry-year level
    - Alternative measure: *Delisting rate* on the industry-year level

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  - The latter; optimal dismissal decisions, rather than distorted by entrenched CEO
    - Powerful CEOs are not associated with underperformance
    - Powerful CEOs are associated with higher stock returns during the 2020 Coronavirus Stock Market Crash

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    - The latter; optimal dismissal decisions, rather than distorted by entrenched CEO
        - Powerful CEOs are not associated with underperformance
        - Powerful CEOs are associated with higher stock returns during the 2020 Coronavirus Stock Market Crash
- What mechanisms make powerful CEOs particularly valuable under uncertainty?
    - willingness to share information with the board
    - capability to take swift action

Data Summary

Data Sources

- CEO turnovers: Gentry et al. (2021)
- CEO characteristics and compensation: Execucomp
- Board characteristics: Boardex
- Firm characteristics and performances: Compustat and CRSP
- Analyst forecasts: IBES

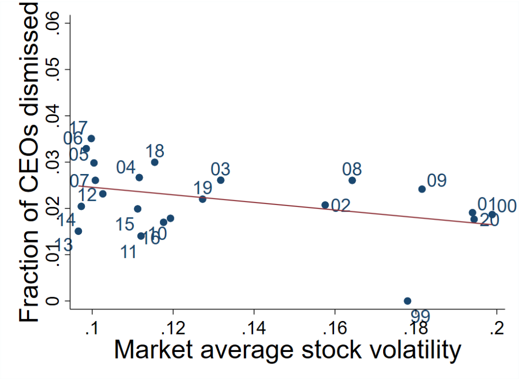
Sample Summary

- Panel data: 2,732 US public firms between 1999 and 2020 (32,033 firm-years)
- 900 forced CEO turnovers (2.8% firm-years)
- CEO-chair duality among 54% firm-years

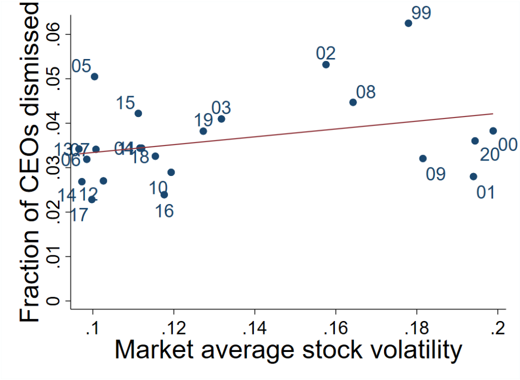
Results

Q1: Are powerful CEOs less likely to be dismissed under higher uncertainty?

CEO Dismissals on the Market Level



Powerful CEOs



Other CEOs

- Uncertainty ↑: dismissal(powerful CEOs) ↓ ; dismissal(other CEOs) ↑

Empirical Specification

- Panel data regression model with year and industry (or year-by-industry) fixed effects

$$\begin{aligned} \textit{Forced turnover}_{it} = {} & \beta_0 + \beta_1 \textit{Uncertainty}_{It} + \beta_2 \textit{CEO power}_{it} \\ & + \boldsymbol{\beta_3} \textit{CEO power}_{it} \times \textit{Uncertainty}_{It} + B_4 X_{it} \\ & + B_5 X_{it} \times \textit{Uncertainty}_{It} + d_I + d_t (\textit{or } d_{It}) + \varepsilon_{it} \end{aligned} \tag{1}$$

with

- $\textit{Forced turnover}_{it}$: forced turnover dummy of firm i in year t
- $\textit{Uncertainty}_{It}$: uncertainty of industry I in year t
- $\textit{CEO power}_{it}$: the power of the CEO of firm i in year t
- X_{it}: controls
- d_I: industry FE; d_t: year FE
- $d_I t$: industry-by-year FE
- ε_{it}: error term, adjusted for heteroskedasticity and industry-level clustering

Regression of CEO Dismissals

Dependent variable =	Forced turnover dummy	
Uncertainty	0.060	
	(0.14)	
CEO power	0.005	-0.000
	(0.01)	(0.00)
CEO power $\times$ Uncertainty	-0.104***	-0.095***
	(0.04)	(0.03)
Year FE & Industry FE	Yes	No
Year-Industry FE	No	Yes
Controls	Yes	Yes
Obs	32033	32033

- The dismissal rate of powerful CEOs significantly decreases with uncertainty
- Uncertainty $\uparrow$ one SD $\rightarrow$ dismissal rate(powerful CEO) $\downarrow$ 0.47%
  - Economically significant: the average rate is 2.31%

Q2: Is the fact that powerful CEOs are less likely to be dismissed under higher uncertainty optimal for firms?

Two Theories of CEO Turnover

- Optimal dismissal theory (Gibbons and Murphy, 1990; Bushman et al., 2010)
  - Boards make retention or dismissal decisions in the best interests of shareholders
  - Less dismissals $\rightarrow$ Firms' preferences for powerful CEOs increase with uncertainty

Two Theories of CEO Turnover

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    - Boards make retention or dismissal decisions in the best interests of shareholders
    - Less dismissals $\rightarrow$ Firms' preferences for powerful CEOs increase with uncertainty
- Entrenchment theory (Shleifer and Vishny, 1989; Hermalin and Weisbach, 1998)
    - Entrenched CEOs can distort the retention or dismissal decisions in their own favour
    - Less dismissals $\rightarrow$ Powerful CEOs' entrenchment cost increases with uncertainty

Firm Performance

Dependent variable =	Q	
Uncertainty	1.930*	3.641**
	(1.12)	(1.46)
CEO power	0.010	-0.037
	(0.07)	(0.06)
CEO power $\times$ Uncertainty	0.412	0.767
	(0.55)	(0.49)
Year FE & Firm FE	Yes	Yes
Controls	No	Yes
Obs	28569	28569

- No evidence that powerful CEOs retained in uncertain times underperform
- Similar results if measuring performance by *ROA* or *Sales growth*

Stock return during the 2020 Coronavirus Stock Market Crash

Dependent variable =	Cumulative return Feb 20th to Mar 20th			
Year =	2020		2019	
CEO power	0.030***	0.028***	-0.007	-0.006
	(0.01)	(0.01)	(0.00)	(0.00)
Firm Size		0.009**		0.001
		(0.00)		(0.00)
Constant	-0.411***	-0.417***	-0.015***	-0.016
	(0.01)	(0.05)	(0.00)	(0.02)
Controls	No	Yes	No	Yes
Obs	1427	1424	1539	1537

- To mitigate the endogeneity concern of CEO power, use the onset of the COVID-19 pandemic as an unanticipated sudden surge in uncertainty
- Powerful CEOs are favoured by the market in uncertain times

Q3: What mechanisms make powerful CEOs particularly valuable under uncertainty?

Mechanism 1: Better Information Sharing

- In uncertain times, new information is generated at an accelerated rate
- Powerful CEOs may be more willing to share information with the board (Adams and Ferreira, 2007)
- Prediction: powerful CEOs should be especially beneficial for obscure firms

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- Powerful CEOs may be more willing to share information with the board (Adams and Ferreira, 2007)
- Prediction: powerful CEOs should be especially beneficial for obscure firms
- Method:
  - Divide firm-years into two groups by information asymmetry
  - Run regressions of CEO dismissal within each group

Mechanism 1: Better Information Sharing

	Dependent variable =	Forced turnover dummy	
	Measure for uncertainty =	Stock volatility	Delisting rate
Obscure firms	CEO power $\times$ Uncertainty	-0.120**	-0.216***
		(0.06)	(0.07)
	Obs	15105	15105
Transparent firms	CEO power $\times$ Uncertainty	-0.046	-0.024
		(0.05)	(0.06)
	Obs	16028	16028
	Year FE	Yes	Yes
	Industry FE	Yes	Yes
	Controls	Yes	Yes

- Among obscure firms, powerful CEOs are less likely to be dismissed in uncertain times

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- Among obscure firms, powerful CEOs are less likely to be dismissed in uncertain times
- Insignificant results among transparent firms.

Mechanism 2: Higher Response Speed

- The CEO runs a firm daily, while board directors often have other commitments
- In uncertain times, slower decision-making is more costly
- Prediction: for firms with busier directors, having a CEO with more decision-making power should be especially beneficial

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- The CEO runs a firm daily, while board directors often have other commitments
- In uncertain times, slower decision-making is more costly
- Prediction: for firms with busier directors, having a CEO with more decision-making power should be especially beneficial
- Method:
  - Divide firm-years into two groups by the average busyness of board directors
  - Run regressions of CEO dismissal within each group

Mechanism 2: Higher Response Speed

	Dependent variable =	Forced turnover dummy	
	Measure for uncertainty =	Stock volatility	Delisting rate
Busier directors	CEO power × Uncertainty	-0.141**	-0.209**
		(0.06)	(0.09)
	Obs	15697	15697
Less busy directors	CEO power × Uncertainty	-0.053	-0.073
		(0.07)	(0.07)
	Obs	16336	16336
	Year FE	Yes	Yes
	Industry FE	Yes	Yes
	Controls	Yes	Yes

- Among firms with busier directors, powerful CEOs are significantly less likely to be fired under higher uncertainty

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- Among firms with busier directors, powerful CEOs are significantly less likely to be fired under higher uncertainty
- Insignificant results among firms with less busy directors

Conclusion

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- Powerful CEOs are less likely to be dismissed under higher uncertainty
- Optimally determined by the board, rather than distorted by CEO entrenchment
- Two potential mechanisms for why powerful CEOs become more preferred under higher uncertainty
  - Better information sharing
  - Higher response speed
- This study challenges the view that CEO power is always manipulative and detrimental