## ВЛИЯНИЕ ГЛОБАЛЬНЫХ ВЫЗОВОВ НА КОМПАНИИ И ИНДУСТРИИ (IMPACT OF GLOBAL CHALLENGES ON COMPANIES AND INDUSTRIES)

UDC 338

**Chu Ngoc Duy Ly**,
student,
Department of Economics and Management,
Graduate School of Economics and Management,
Ural Federal University named after the first President of Russia B.N. Yeltsin
Yekaterinburg, Russian Federation

# THE IMPACT OF CHANGING CEOS ON MARKET VALUE OF GLOBAL COMPANY

*Abstract*:
The article analyzes the impact of changing CEOs on the market value of a global company, studies the determinants of CEO turnover, looks at the correlation between CEO's gender and market value, and determines the consequences of management change in company

*Keywords*:
Global, market value, company, enterprise, CEO, leader, manager,turnover, change, impact

In an increasingly competitive world, companies try to find new ways to grow and remain profitable as good market value is associated to effective leadership. In a 2014 article in Forbes, Monster Beverage was listed as one of America's best-managed companies, after assessing how much its current management (and in particular its CEO Rodney Sacks) had contributed. The Economist ("How Netflix Became a Billion-dollar Titan") attributed to its Chief Content Officer the right decisions that led to the company's dominance in the streaming industry. Conversely, corporate underperformance and failure are usually the result of bad leadership practices. In April 2013, when Apple plunged below USD400 a share, a campaign with the headline "Tim Cook Should Go" ensued. Earlier, an article in TheStreet had claimed, if Steve Jobs Were Alive, He Would Fire Tim Cook.

Accordingly, the academic literature has identified a positive relationship between leadership and market value. There are copious experimental studies about market reaction to information disclosure, which cover a wide range of information such as stock split, inventory change, release of earnings announcements, etc. Meanwhile, information about management change is one of the most important types of information that can trigger a market reaction. The CEO change, whether voluntary or mandatory, is critical to the improvement of a company performance. The new CEO rectifies the drawbacks and mistakes of the former CEO and attempts to develop new policies that demonstrate his capabilities. A new CEO wields influence not only on management decisions, but also information disclosure strategies of the company, including financial and non-financial data.

By the most part, the evidence presented in the literature is that CEOs explain between 4 percent and 15 percent of firm performance and market value. Because such valuation effects exceed by far their compensation, the conclusion is, therefore, that top executives create value. In a great paper, Bandiera et al. (2020) confirm that the more managers lead, the higher the company's accounting profitability and revenues. They also show that, whenever the job market for CEOs is deep enough, companies hire top executives who match their needs (for either a leader or a manager), so the CEO is more impactful when there is a match between their skill and the company.

## II. Literature Review

### 1. The Impact of CEOs on Market Value

When analyzing the importance of leadership on firm value, traditionally the leadership literature has focused on assuming that a mediating variable is directly related to market value, and subsequently analyzes the impact of leadership characteristics on such mediating variable. Example of such mediating variables are organizational performance, motivation, risk-taking, culture, adoption of best practices, employee satisfaction, and speed of job completion. Measurement of the CEO impact on 's market value is not a straightforward task due to a variety of factors implying complex interdependency (Blettner et al., 2012). Firm's market value is shown to be positively related to the number of hours CEOs work (Bandiera et al., 2015), career and educational achievements (Falato et al., 2015), general ability and execution skills (Kaplan et al., 2012), CEO humility (Ou et al., 2018), their cultural heritage (Nguyen et al., 2018) and CEO reputation (Milbourn, 2003; et al., 2015). Such a variety of identified factors along with the estimation difficulties raise the question whether CEO characteristics and traits are of any relevance to market value. A big issue in these studies is that the causality between CEO characteristics and the impact on the mediating variable could be endogenous - so a firm with propensity to avoid risks will hire a risk-averse CEO, who in turn will prevent the company from taking risky projects. To determine the direct influence of a CEO, over a period of time you would need to study the same company in the same circumstances, with the only difference being the CEO. Bennedsen et al (2007) conducted a study using a sample of Danish companies where the CEO had died suddenly and unexpectedly, and was quickly replaced. They identified 6; 753 deaths of CEOs and/or their family members. Furthermore, the authors meticulously sorted the tragic events into 1; 015 CEO deaths, 733 spouses' deaths, 282 children's deaths, 3; 061 parents' deaths, and 1; 364 parents-in-laws' deaths. In defining firm performance, they looked at operating return on asset (OROA), investment, and sales growth. Their study found that either the sudden death of the CEO or the death of the CEO's close family member was significantly related to a firm's decline in profitability, investment, and sales growth.

Similarly, Bertrand and Schoar (2003) constructed a manager-firm matched dataset that allowed them to track the same top managers cross different firms over time using Forbes 800 files from 1969 to 1999. In measuring corporate's market value, they utilized various financial indicators to reject firm 's market value including total sales, investment, cash flow leverage, cash holding, and return on asset.

There are some interesting findings from their study. First, managers matter, both economically and statistically, to the policy decisions of firms. Second, the realization of all investment, financing, and other organizational strategies systematically depends on the specific executives in charge. Third, managerial differences in corporate practices are systematically related to differences in corporate performance. Fourth, managers with higher's market value receive higher compensation. The third result is important: CEOs make a difference in results. However, the magnitude is not stellar: the authors calculate that individual CEOs only contribute to between 2 and 4 percent of total performance. That is, if Apple's profit margin in 2018 has been 38 percent, Tim Cook's individual decisions would be able to add, or detract, at most 1.5 percent per year.)

The question whether CEOs affect the's market value at all, or the observed differences are a result of pure lack, remains an open scholarly debate. CEOs are rewarded for luck as much as they are for performance, which is even more pronounced for poorly performing firms (Bertrand and Mullainathan, 2001). Later studies confirm these results and suggest that the so-called CEO effect on performance results from erroneous distribution of chance factors on performance (Fitza, 2014). However, Fitza's study was criticized for the lack of methodological rigor as the application of more advanced methods lends support for the CEO-effect (Quigley and Graffi n, 2017). In turn, Fitza showed that under a more realistic set of assumptions the CEO is statistically indistinguishable from pure lack irrespective of the estimation method used, which is caused by performance persistence effect (Fitza, 2017).

In the attempt to resolve the apparent paradox, later studies emphasize the role of autocorrelation (performance persistence) but still find evidence of the CEO-effect (Ronkko and Maheshwaree, 2018).

This paper is close to Bandiera et al (2020), who characterize CEOs as either leaders or managers through a CEO behavior index that assigns a value of 0 to managers, and a value of 1 to leaders.

They measured the behavior of 1114 CEOs in six countries, parsing granular CEO diary data through an unsupervised machine learning algorithm. Their study identified two types of CEO behaviors: 'managers' and 'leaders.' Managers focus on one-to-one meetings with core functions, while leaders focus on multi-function, high-level meetings with core functions. Importantly, Bandiera et al. (2020) conclude that corporate institutions with leaders are, on average, more productive than firms with managers, and this difference becomes apparent when CEOs are hired. They show, in a sample of more than 3000 firms from 6 countries, that a one-standard deviation increase in the CEO behavior index is associated with an increase of 7 percent in sales, controlling for firm characteristics. Interestingly, they report that 17 percent of the variance in the index is driven by country and industry characteristics.

Bandiera et al. (2020) are able to reject the null hypothesis that CEOs adjust their behaviors to the companies that hire them. They also confirm the hypothesis of vertical differentiation among firms, where some hire a leader and some hire a manager. Instead, they find evidence consistent with horizontal differentiation of CEOs with matching frictions -meaning that some firms end up hiring the wrong CEO because of a short supply of top executives, especially in some countries

**2. The Determinants of CEO Turnover**

The relationship between CEO dismissal and firm's market value is an open scholarly debate (Eisfeldt and Kuhnen, 2013). Theory suggests that CEOs can be fired if performing suboptimally, or if they perform exceptionally well so that it becomes too expensive to motivate them (Spear and Wang, 2005).

Both propositions have gained empirical support. Poor market value is one of the strongest predictors of CEO dismissal (Hilger et al., 2013). Higher compensation paid to CEOs is positively associated with the probability of CEO turnover (Peters and Wagner, 2014). However, male CEOs are less likely to be dismissed when the firm's market value is high, while for female CEOs the likelihood remain equally high irrespective of the firm's market value (Gupta et al., 2020). CEO are more likely to be dismissed due to reasons beyond their control, such as adverse industry events as compared than adverse market events (Eisfeldt and Kuhnen, 2013; Jenter and Kanaan, 2015). Deteriorating industry conditions are a predictor of forced CEO turnover (Eisfeldt and Kuhnen, 2013). Volatile industry conditions were shown to increase the probability of dismissal (Peters and Wagner, 2014). Peters and Wagner (2014) show that CEOs of companies experiencing volatile industry conditions are more likely to be dismissed.

CEO entrenchment is positively associated with poor governance and was shown to cost shareholders 3 percent in value (Taylor, 2010). Given the high importance of firm's market value, substantial research attention was directed towards the link between CEO traits and characteristics and organizational outcomes. Research suggests that individuals tend to overemphasize the importance of leadership for the organizational outcomes as compared to other factors, the phenomenon that became known as "the romance of leadership " (Meindl et al., 1985). Moreover, good market value is valued higher if it is believed to be an outcome of good leadership to the extent that poor market value of companies headed by managers who are believed to be good top executives can be overlooked (Meindl et al., 1985). Furthermore, higher level executives are held accountable for the firm's market value to a greater extent than lower level ones (Fee and Hadlock, 2003).

Another important research debate relates to the role of managerial talent and its effect on firm performance and value. More talented and risk-tolerant executives are attracted to firms with high-powered incentive schemes, which in turn reveal better performance in terms of productivity, profits and return on capital (Bandiera et al., 2015). Variation in CEO talent levels was shown to account for 2 percent of the differences in firm value (Chang and Hong, 2019). At a more granular level, managerial talent was shown to be related to performance for buyout CEOs, while for venture capital CEOs the evidence is mixed (Kaplan et al., 2012). However, the talent distribution among CEOs managing the largest firms is very flat, which implies that the differences in talent do not directly translate into differences in the firm value or translate to a very limited degree (Gabaix and Landier, 2008; Tervio, 2008).

Gao et al (2017) compare chief executive officer (CEO) turnover in public and large private firms. Public firms have higher turnover rates and exhibit greater turnover -performance sensitivity (TPS) than private firms. However, controlling for pre-turnover performance, performance improvements are greater for private firms than for public firms. This research suggests that public firms' CEOs are dismissed due to negative market value that is not caused by the CEO. Gao et al. (2017) investigate whether these differences are due to differences in quality of accounting information, the CEO candidate pool, CEO power, board structure, ownership structure, investor horizon, or certain unobservable differences between public and private firms. They find strong support for investor myopia contributing to public firms'higher turnover rates and greater TPS. Extant research assessed the relationships between culture and CEO remuneration and dismissal.

Evidence from a cross-country study covering 14 countries suggests that CEO compensation is culturally-defined and therefore country-dependent (Burns et al., 2017). In turn the probability of CEO dismissal is lower in countries characterized by high power distance, however, the likelihood is positively affected by status in congruence (Li et al, 2017)

## 3. CEO Gender and Market Value

Women are underrepresented at the top management level (Klein et al., 2019). While it was long believed that this fact is an outcome of the so-called "glass ceiling" recent renumeration -based evidence suggests that this may be no longer be the case (Bugeja et al., 2012). However, research suggests that investors tend to perceive female CEOs as less competent compared to their male counterparts (Lee and James, 2007). On the contrary, other studies argue for the existence of the so-called "female premium" that benefits female CEOs (Leslie et al., 2017). An alternative potential explanation for underrepresentation of women among CEOs is the awareness of female candidates of lower stability of such roles for women (Klein, 2019) and higher probability of being dismissed as compared to men (Gupta et al., 2020).

Little research attention was directed to the relationship between CEO gender and firm's market value. Extant research suggests that female leadership and, in particular, women in CEO roles benefit firm's market value in more egalitarian cultures (Hoobler et al., 2018). However, it is argued that the success of female CEOs can at least partially be explained by performance persistence effect and, consequently, the market value achieved by their predominantly male predecessors (Dwivedi, 2018).

## 4. Consequences of Management Change

The stock market is sensitive and concerned with corporate management. Hence, whenever there is a management change, one natural assumption is the incompetence of managers in doing their job, i.e. increasing shareholder wealth. The process of management change can be seen as a strategy undertaken by owners in order to align the company with environmental changes. This process is an intervention mechanism that reflects the present and future presence of the company (Bizjak, et al., 2009).

In this regard, researchers have also suggested that employing outside managers, in addition to its usefulness and efficiency for the company, is also needed to successfully implement a management change strategy. Various researches have looked into the link between management change and the performance of successors in different enterprises and organizations and divergent outcomes have been reported. Furtado & Karan (2021), in a study on management change in 108 small-sized manufacturing companies, found that only companies with pre-determined management change policy remained profitable after management change. On the other hand, in the period following management change, new managers intend to incorporate earning bath into their plans. This novel strategy of new managers fosters their ability in more effective reporting of company performance.

The stock market response can be approached from two perspectives. One is that the change of top managers in a company, as vital human capitals of that company, will be accompanied with certain earnings or losses for the company. Moreover, management change is associated with certain signs and symptoms. In other words, managers are fully cognizant of all the details of the company so that they can be perceived as special human assets of a company. When these managers leave a company or when there are few replacements to fill in their position, such changes would influence the value of the company. However, if the new management is as competent and adroit as the former managers, these changes are not expected to wield a significant impact on the company value.

In the latter case, the stock market response to high-level management change is driven by signals that such changes transmit to the market. The senior managers have access to information that is not publicly available. In other words, they possess classified and confidential information. Therefore, any alteration in their position can undermine the stock market's perception of the company's current and future status. A fundamental problem is the opposing attitudes that people outside the company hold about such signals. For example, a change may be an indicator of the sustainability of company policies, restructuring of the company's assets, adjustments of investment opportunities, dismissal of key executives involved in company's lackluster performance, or all of the above.

It is also likely that the above changes do not carry any information in the current situation as they already reflect market prices. Therefore, the effect of change signals on the company value could be positive, negative, or natural.

In an efficient market, however, stock returns are influenced by a host of factors related to managerial performance. Price return alone does not reflect the unexpected or expected aspect of the management change but is shaped by a variety of factors (Warner et al., 2019). Despite the variety of factors that govern price returns, there are different sources of information such as periodic reports of earnings, capital increase, profit sharing, etc. that may represent criteria closely linked to the management performance. It is sometimes difficult to distinguish the impact of above information on the company performance. It is likely that due to the integration and synchronization of financial information, price returns may not be able to accurately reflect each criterion separately. It is worth noting, however, that when the Board of Directors is bound to take measures for the change of the company's CEOs, information related to this change will not fully reflected in price returns. This is mainly driven by the fact that the Board of Directors looks for factors that are not clear to the capital market and its members. This indicates that, although the board of directors is obligated to be accountable to management's performance, these reasons are not measurable by those outside the company.

What can be inferred from the aforementioned research is that capital markets react to changesin corporate management that depend on investor behavior.

Overall, the extant research suggests a great degree of variability in the relationship between CEO traits, characteristics and skills and firm market value. While some studies suggest that CEOs do affect firm market value in one or another way, others reject this proposition and attribute the observable differences in organizational outcomes to performance persistence effect and pure lack. The issues clearly merits further investigation

## III. Conclusion

The process of management change in a company can be seen as a strategy adopted by the authorities to align it with environmental changes. This is an intervention mechanism that reflects the current and future presence of the company. Most researches have explored the link between management change and the performance of successors in different enterprises and organizations and divergent results have been reported (Furtado & Karan, 2021; H. DeAngelo & L. DeAngelo (1989); Bizjak, Lemmon, & Naveen, 2009). According to the results, in companies that witnessed a decline in their earnings, this drop was particularly sharp during CEO changes. On the other hand, given that senior executives are responsible for controlling the company's resources, any change in management team may wield the greatest impact on company value and subsequently on shareholders' wealth. Hence, it is vital to examine the stock market reaction to these changes and their effects.In this regard, the present study also investigated the market reaction to CEO change and its effect on stock's abnormal returns. Using a sample of firms from 22 countries (to identify, not only the different performance of CEOs by country, but also to control for country-specific variables), 17 industry groups, and for the period 1990 to 2019 (controlling for country and industry effects, year-fixed effect to capture the impact of global factors), the results of hypothesis testing indicated that there was a negative and significant link between CEO change and stock's abnormal returns. In other words, it can be argued that during CEO change, stakeholders tend to underrate stock prices, which results in a lower estimation of stock returns compared to its actual value. Therefore, negative abnormal returns were observed in years of CEO changes. The results of this study are in line with those presented by Bizjak et al. (2009), Hu and Kumar (2004), Hermalin and Weisbach (2001), Furtado & Rozeff (1987). In light of the above results, investors are advised not to consider CEO change as a regular event and to pay special attention to the CEO's tenure and the remaining years of his service as an influential factor on stock returns when they intend to make any investment.

## REFERENCES

1. Adams, R.B., Almeida, H. and Ferreira, D. (2005), 'Powerful CEOs and their impact on corporate performance," The Review of Financial Studies, 18(4), 1403-1432.
2. Adams, R., M. Keloharju, and S. Kn pfer (2018), 'Are CEOs born leaders? Lessons from traits of a million individuals," Journal of Financial Economics 130, 392-408.
3. Bandiera, O., A. Prat, S. Hansen, and R. Sadun, (2020), 'CEO Behavior and Firm Performance," Journal of Political Economy 128, no. 4: 1325-1369.
4. Bandiera, O., L. Guiso, A. Prat, and R. Sadun (2015), 'Matching Firms, Managers, and Incentives," Journal of Labor Economics 33, 623-681.
5. Bandiera, O., R. Lemos, A. Prat, and R. Sadun (2018), 'Managing the Family Firm: Evidence from CEOs at Work," The Review of Financial Studies 31, 1605-1653.
6. Bertrand, M., and S. Mullainathan (2001), 'Are CEOs Rewarded for Luck? The Ones Without Principals Are," The Quarterly Journal of Economics 116, 901-932.
7. Bertrand, M., and A. Schoar (2003), 'Managing with Style: The Effect of Managers on Firm Policies," The Quarterly Journal of Economics 118, 1169-1208.
8. Blettner, D. P., F. R. Chaddad, and R. A. Bettis (2012), 'The CEO Performance Effect: Statistical Issues and a Complex Fit Perspective," Strategic Management Journal 33, 986-999.
9. Boyd, B.K. (1995), 'CEO duality and firm performance: A contingency model,"Strategic management journal, 16(4), 301-312.

10. Brooks, R. and Negro, M.D. (2006), 'Firm-level evidence on international stock market comovement," Review of Finance, 10(1), 69-98
11. Davidson, R., Dey, A. and Smith, A. (2015), 'Executives’s"off-the-job" behavior, corporate culture, and financial reporting risk," Journal of Financial Economics, 117(1), 5-28
12. Eisfeldt, Andrea L., and Camelia M. Kuhnen (2013), 'CEO turnover in a competitive assignment framework," Journal of Financial Economics 109, 351-372.
13. Elsayed, K. (2007), 'Does CEO duality really affect corporate performance?. Corporate Governance: an international review," 15(6), 1203-1214
14. Falato, A., D. Li, and T. Milbourn (2015), 'Which Skills Matter in the Market for CEOs? Evidence from Pay for CEO Credentials," Management Science 61, 2845-2869.
15. Fahlenbrach, R. (2009), 'Founder-CEOs, Investment Decisions, and Stock Market Performance," Journal of Financial And Quantitative Analysis 44, 439-466
16. Fernandes, N., Ferreira, M.A., Matos, P. and Murphy, K.J., (2013), 'Are U.S. CEOs Paid More? New International Evidence," Review of Financial Studies 26, 323-367.
17. Fee, C. Edward, and Charles J. Hadlock (2003), 'Raids, Rewards, and Reputations in the Market for Managerial Talent," Review of Financial Studies 16, 1315-1357.
18. Fitza, M. A. (2014), 'The use of variance decomposition in the investigation of CEO effects: How large must the CEO effect be to rule out chance?," Strategic Management Journal 35, 1839-1852.
19. Gabaix, X., and A. Landier (2008), 'Why Has CEO Pay Increased So Much?," Quarterly Journal of Economics 123, 49-100.
20. Hambrick, D.C. and T.J. Quigley (2014). 'Toward more accurate contextualization of the CEO effect on firm performance," Strategic management journal, 35(4), 473-491
21. Harford H. and R.J. Schonlau (2013), 'Does the director labor market offer ex post settling-up for CEOs? The case of acquisitions," Journal of Financial Economics 110, 18-36.
22. Hilger, S., S. Mankel, and A. Richter (2013), 'The use and effectiveness of top executive dismissal," The Leadership Quarterly 24, 9-28.
23. Hoobler, J. M., C.R. Masterson, S.M. Nkomo, and E.J. Michel (2018), 'The Business Case for Women Leaders: Meta-Analysis, Research Critique, and Path Forward," Journal of Management 44, 2473-2499.
24. Jacobson, R. (1987), 'The Validity of ROI as a Measure of Business Performance." American Economic Review 77 (3): 470
25. Jensen M.C., and K.J Murphy (1990), 'Performance Pay and Top-Management Incentives,"Journal of Political Economy 98(2), 225-264.
26. Jenter, D., and F. Kanaan (2015), 'CEO Turnover and Relative Performance Evaluation: CEO Turnover and Relative Performance Evaluation," The Journal of Finance 70, 2155-2184.
27. John, K., S. A. Ravid, and J. Sunder (2017), 'Managerial ability and success: Evidence from the career paths of film directors," Journal of Corporate Finance 44, 425-439.
28. Kaplan, S.N., M.M. Klebanov, and M. Sorensen (2012). 'Which CEO characteristics and abilities matter?," The Journal of Finance, 67(3), 973-1007
29. Leslie, L. M., C. F. Manchester, and P. C. Dahm (2017), 'Why and When Does the Gender Gap Reverse? Diversity Goals and the Pay Premium for High Potential Women,"Academy of Management Journal 60, 402-432.
30. Li, W., Y. Lu, S. Makino, and C.-M. Lau (2017), 'National power distance, status in congruence, and CEO dismissal," Journal of World Business 52, 809-818.
31. Mackey, A. (2008), 'The effect of CEOs on firm performance," Strategic Management Journal, 29(12), 1357-1367.
32. Malmendier, U., and G. Tate (2009), 'Superstar CEOs," Quarterly Journal of Economics, 124(4), 1593-1638.
33. Peters, F. S., and A. F. Wagner (2014), 'The Executive Turnover Risk Premium: The Executive Turnover Risk Premium," The Journal of Finance 69, 1529-1563.
34. Ronkk o, M., and P. Maheshwaree (2018), 'The CEO Effect and Performance Variation Over Time," Academy of Management Proceedings 2018, 16480.
35. Shiller, R.J. (2014), 'Speculative asset prices," American Economic Review, 104(6), 1486-1517
36. Shiller, R.J. (2007), 'Low interest rates and high asset prices: An interpretation in terms of changing popular economic models," National Bureau of Economic Research WP No. W13558.
37. Spear, S. E., and C. Wang (2005), 'When to fire a CEO: optimal termination in dynamic contracts," Journal of Economic Theory 120, 239-256.
38. Taylor, L. A. (2010), 'Why Are CEOs Rarely Fired? Evidence from Structural Estimation," The Journal of Finance 65 (2051-2087).
39. Tervio, M. (2008), 'The Difference That CEOs Make: An Assignment Model Approach,"American Economic Review 98, 642-668.
40. Yim, S. (2013), 'The Acquisitiveness of Youth: CEO age and Acquisition Behavior," Journal of Financial Economics 108, 250-273