

# BOARD OF DIRECTORS TURNOVER AND FIRM PERFORMANCE

Brian Bolton<sup>\*</sup>, Jung Park<sup>\*\*</sup>

<sup>\*</sup> Moody College of Business, University of Louisiana at Lafayette, Lafayette, the USA

<sup>\*\*</sup> ISG Paris (Institut Supérieur de Gestion), Paris, France;  
Idiap Research Institute, Martigny, Switzerland



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## Abstract

In this study, we analyze what happens to firm performance when boards of directors re-invent themselves. Boards can re-invent themselves in a variety of ways — new committees, more meetings, different compensation — but the most direct way that the structure and culture of a board changes are through turnover and replacement of board members. We study this turnover from two directions: the board chair being replaced and the proportion of non-chair directors being replaced.

Our motivation for this study goes back several years to the literature on corporate governance entrenchment. Bebchuk, Cohen, and Ferrell (2009) created an *Entrenchment Index* and showed that firms with more entrenched governance are associated with better firm performance; this followed Gompers, Ishii, and Metrick's (2003) seminal study using a broader measure of entrenchment showing that stock prices decreased when boards were more entrenched. Zerni, Kallunki, and Nilsson (2010) show that this entrenchment problem can extend to large investors, through different control mechanisms (such as dual-class shares). Bhagat and Bolton (2013) specifically study CEO turnover, finding that better governed firms are more likely to fire CEOs given

poor firm performance, while poorly governed firms are less likely to replace CEOs given poor performance. However, there can be certain situations where managerial entrenchment can help the firm execute its long-term strategies, such as with innovation. Chemmanur and Tian (2018) show that firms subject to more anti-takeover provisions innovate more; Manso (2011) suggests that managers can be motivated to innovate by incentivizing them with long-term options, golden parachutes and other devices that encourage entrenchment. Yet few studies have focused exclusively on turnover on and within the board of directors. We contribute to this literature by analyzing the dynamic interactions between board chair turnover and non-chair director turnover.

To extend the prior literature on CEO and managerial turnover to the board of director turnover and firm performance, we propose the following hypotheses:

*H1: Board chair turnover leads to improved firm performance.*

*H2: Turnover of non-chair directors moderates the impact of chair turnover.*

*H1* follows from prior literature showing that disciplinary turnover following poor firm performance is associated with superior firm performance. *H1* is consistent with this, suggesting that a firm replacing the board chair will, in general, lead to superior performance. Note that it is rare to see cases of disciplinary chair turnover disclosed, as we typically see with CEO turnover. Chair turnover is generally reported as passive, non-disciplinary and voluntary. Of course, some cases of chair turnover might be disciplinary or active, such as following poor performance, ethical issues or a merger. Even though we cannot distinguish between disciplinary and non-disciplinary chair turnover, such distinctions will exist and may illuminate relationships in our study. *H2* follows from management and strategy research that shows how managerial turnover can have extremely disruptive organizational consequences, especially when the board is unable to manage those transitions. Marcel, Cowen, and Ballinger (2017) show that this is uniquely the case with an interim leader, but that this effect is moderated by situational characteristics. Quigley and Hambrick (2012) show that when a CEO steps down but stays on as a director it compromises the ability of both the new CEO and the overall board to drive strategic change. Thus, greater turnover leads to greater disruption and less alignment within the boardroom, which is likely to diminish the firm's ability to improve performance.

This study is an empirical study analyzing what happens to firm performance following board chair and/or director turnover. The key elements of the empirical design are as follows:

- Large U.S. firms from the S&P SuperComposite 1500 over 2001–2018.
- Chair turnover is measured as a 1–0 binary variable if chair is new.
- Director turnover is measured as the percentage of independent directors who are new in a given year.
- We use pooled OLS regressions methodology.
- The dependent variable is *EBIT* growth, defined as the year-over-year growth in earnings before interest and taxes relative to the base (turnover) year.

$$EBIT\ Growth_{t+1} = \beta_1 New\ Board\ Chair_t + \beta_2 Director\ Turnover_t + \beta_3 Director\ Network\ Size_t + \beta_4 Chair\ Time\ On\ Board_t + \beta_5 (New\ Board\ Chair_t \times Director\ Turnover_t) + \beta_6 (Director\ Turnover_t \times Director\ Time\ on\ Board_t) + Controls \tag{1}$$

Our preliminary findings show some very interesting results, contrary to both of our primary hypotheses. The results in the following table summarize our main results — which all need further exploration to better understand what is driving them:

**Table 1.** Firm level pooled linear analysis results

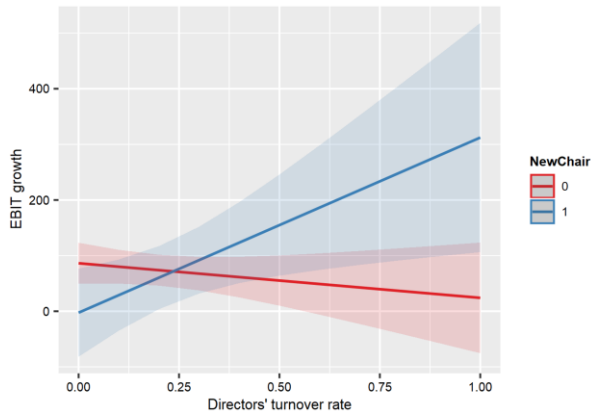
Dependent variable	EBITgrowth			
	(1)	(2)	(3)	(4)
NewChair		-12.211 (31.056)	-92.883* (43.621)	-12.036 (31.058)
TurnOver		-5.447 (55.517)	-71.476 (60.909)	-74.694 (122.115)
DirectorNetworkSize	-0.001 (0.013)	-0.001 (0.013)	-0.001 (0.013)	-0.001 (0.013)
TimeonBoard	-9.565* (3.978)	-9.933* (4.096)	-10.073* (4.096)	-11.707* (4.954)
AgeYrs	-1.537 (3.174)	-1.644 (3.283)	-1.532 (3.283)	-1.766 (3.289)
factor(year)2015	40.836 (73.286)	46.550 (75.949)	44.416 (75.942)	47.119 (75.956)
NewChair:TurnOver			374.217** (142.113)	
TurnOver:TimeonBoard				9.140 (14.356)
Observations	20,304	19,702	19,702	19,702
R <sup>2</sup>	0.005	0.005	0.006	0.005
Adjusted R <sup>2</sup>	0.001	0.001	0.002	0.001
F-statistic	1.833** (df = 77; 20227)	1.782** (df = 79; 19623)	1.847** (df = 80; 19622)	1.765** (df = 80; 19622)

Notes: \*  $p < 0.05$ ; \*\*  $p < 0.01$ .

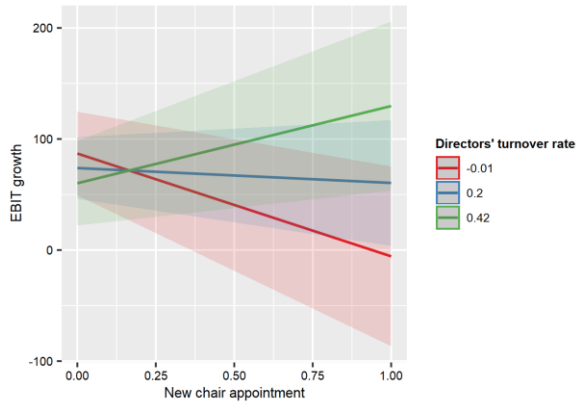
Table 1 presents the results of OLS analysis on the relationship between board turnover and firm performance. *EBIT* growth is the dependent variable; various measures of board chair and board member turnover as explanatory variables are considered in Models 1, 2, 3 and 4. The sample includes U.S. firms included in the S&P SuperComposite 1500 between 2001–2018. *EBIT* growth is the year-over-year growth in earnings before interest & taxes in the fiscal year following the reference year. Chair turnover is a 1–0 binary variable equal to 1 if the board chair is new. Director turnover is measured as the percentage of independent directors who are new in a given year. We use a pooled OLS methodology.

Model 3 is the relevant model, where we see the full interaction of chair and director turnover. We notice that chair turnover alone leads to lower *EBIT* growth; chair tenure also has a negative impact on *EBIT* growth. Director turnover alone has no impact on *EBIT* growth. Importantly, we see that when a firm experiences both chair and director turnover, *EBIT* growth is highly significantly positive. The figures below show this relationship graphically:

**Figure 1.** *EBIT* growth & new board chair



This figure shows the estimates and 95% confidence intervals for *EBIT* growth given either when the board chair is new (blue line) or when the board chair is not new (red line), moderated by the percentage of independent directors who are new in a given year represented on the horizontal axis.

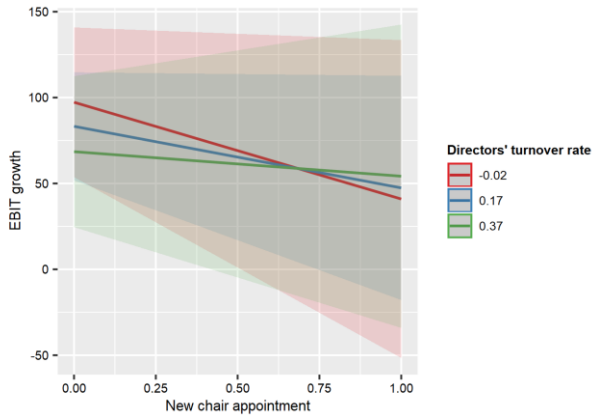
**Figure 2.** *EBIT* growth & director turnover

This figure shows the estimates and 95% confidence intervals for *EBIT* growth across three ranges of independent director turnover — low (red), medium (blue), high (green) — moderated by whether or not the board chair was new along the horizontal axis.

When a firm appoints a new chair, it enjoys greater subsequent *EBIT* growth if there is also more turnover among the non-chair directors. This suggests that the cultural and leadership dimensions of in-board networks are not exclusively driven by the chair; if a board has a toxic or dysfunctional culture, those dynamics are not necessarily tied to one individual but are connected to multiple members of the board of directors, including the board chair. Importantly, the performance improvement only occurs when the chair is replaced along with other directors, suggesting that the full board is responsible for the relative underperformance.

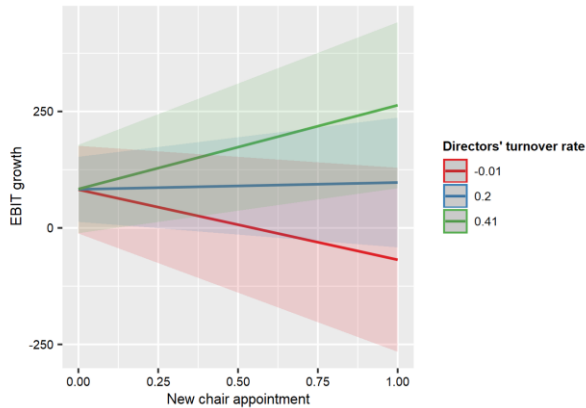
In the following figures, we separate this analysis into three 5-year time periods to explore if this relationship is time-dependent (given that the Global Financial Crisis, and related regulation, occurred in the middle of our sample period). These analyses are in the figures below:

**Figure 3.** Board of director turnover and *EBIT* growth (2001–2005)

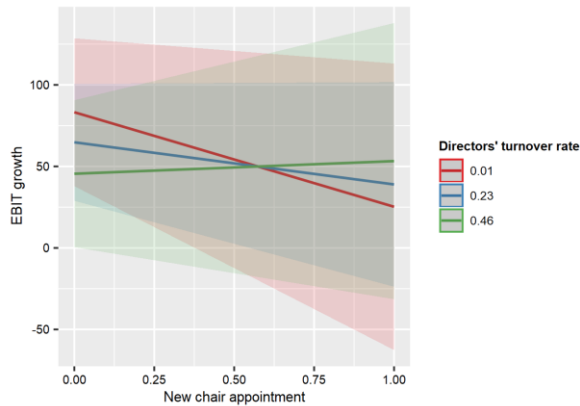


This figure shows the estimates and 95% confidence intervals for *EBIT* growth across three ranges of independent director turnover — low (red), medium (blue), high (green) — moderated by whether or not the board chair was new along the horizontal axis for the years 2001–2005.

**Figure 4.** Board of director turnover and *EBIT* growth (2006–2010)



This figure shows the estimates and 95% confidence intervals for *EBIT* growth across three ranges of independent director turnover — low (red), medium (blue), high (green) — moderated by whether or not the board chair was new along the horizontal axis for the years 2006–2010.

**Figure 5.** Board of director turnover and *EBIT* growth (2011–2015)

This figure shows the estimates and 95% confidence intervals for *EBIT* growth across three ranges of independent director turnover — low (red), medium (blue), high (green) — moderated by whether or not the board chair was new along the horizontal axis for the years 2011–2015.

We see the same general story across the three time periods: when there is a change in the board chair, more director turnover along with that change leads to superior subsequent *EBIT* growth. However, this dynamic is most pronounced in the middle period, 2006–2010, which includes the Global Financial Crisis. This is consistent with prior literature that shows that good governance has the greatest impact in managing leadership turnover following poor performance when disciplinary turnover is most likely.

#### *Outstanding Questions*

This research is ongoing and preliminary. As such, we still have a number of questions to explore and relate to these findings. Some of these outstanding questions include the following:

- Why does chair turnover occur?
- Can we explain the chair and director relationships?
- What if the chair is also the CEO?
- Why are these relationships most pronounced during 2006–2010?
- Are these results moderated or influenced by the firm’s overall governance structure (such as board independence, director ownership, anti-takeover provisions, dual-class share structures)?
- Are these results different for family firms?
- Are these results influenced by ownership structure?
- Are these results consistent across different industries?

We plan to explore these questions, and others, to better understand these dynamics. We know that corporate governance represents the intersection of people and business, and many of the drivers of corporate governance are highly nuanced. Understanding how board chair and director turnover is related to agility, disruption, relationships and future firm performance can be of critical importance to investors, employees, boards and other stakeholders.

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