IS IT BETTER TO CHANGE TOP MANAGEMENT AFTER A MERGER OR ACQUISITION?*

Jian Chen **, ***You-min Xi*** ***

Abstract

In this paper, we analyzed the relationship between turnover of top management and performance of listed companies after takeover. We made a hypothesis that after equity change of listed corporations, the turnover of top management improved the performance of these corporations. We chose the sample of listed corporations in Shenzhen and Shanghai security exchanges which had equity change, and we used the assessment of the "Operating Performance" Methodology to analyze the performance of these listed corporations empirically. We find that the company which had turnover of top management after the corporate control right changed, had significant performance improvement, and had better performance than the company which had not had turnover of top management after the corporate control right changed.

Keywords: Corporate Control, Operating Performance, Top Management turnover

* *Financial Support of this research were provided by 'Excellent Innovative Research Group Funds Project from National Natural Science Foundation of China (grant No. 7012001)' and National Science Foundation of China (grant No. 70473072)*
** *Management School, Xi'an Jiaotong University, Economic and management school, Xi'an technology university, Xi'an, P.R.China. richard.chen@163.com*
*** *Management School, Xi'an Jiaotong University, Xi'an, P.R.China, ymxi@mail.xjtu.edu.cn*

1 Introduction

To replace top management, such as CEO, is always one of the most important decisions made by a board of directors. Because it has long-term implications for a firm's investment, operating, and financing decisions. Many studies of turnover of top management have been found in the literature on organizations. The major focus are always on the determinants of turnover, such as demographic, psychological, and economic antecedents, and models of turnover behavior based on these findings have been developed by theoreticians (e.g., Bluedorn, 1982; Mobley, Griffeth, Hand, & Meglino, 1979; Muchinsky & Tuttle, 1979; Porter & Steers, 1973; Price, 1977). The takeover is always an important cause for the turnover of top management. There are three reasons that had been argued in the management literature about the turnover of top management after a takeover: 'managing change', 'turnaround strategies' and 'culture change'. The turnover of executives has important influences on the postacquisition productivity and employee morale at the acquired firm (Buono and Bowditch, 1989; Schweiger and DeNisi, 1991; Schweiger and Walsh, 1990) and on its postacquisition performance (Cannella and Hambrick, 1993; Ravenscraft and Scherer, 1988).

Would turnover of top management influence firm's performance? Samuelson et al. (1985) compared the performance records of 61 United States corporations wherein the chief executive changed at the mid-point of a seven-year period, with the performance of 61 matched companies where top management remained the same and with industry averages. Among other results, it was found that the changes in the leadership position did not affect revenues and rates of return significantly, but there was evidence that new managers tended to be more cautious about financial risks than tenured managers.

Mark et al. (2001) reported evidence on chief executive officer (CEO) turnover during the 1971 to 1994 period. They found that the nature of CEO turnover activity has changed over time. The frequencies of forced CEO turnover and outside succession both increased. However, the relation between the likelihood of forced CEO turnover and firm performance did not change significantly from the beginning to the end of the period they examined, despite substantial changes in internal governance mechanisms. The evidence also indicated that changes in the intensity of the takeover market are not associated with changes in the sensitivity of CEO turnover to firm performance. High rates of management turnover after a takeover are well documented in literature. Some researchers studied the issue of performance impacts when the top management of target firm turnover after a takeover. Morck et al. (1988) and Walsh (1988) provide

additional evidence of a high rate of top management turnover after a takeover. A popular claim is that a takeover has the disciplinary power of an external market for corporate control. Thus, a takeover is often considered as a mechanism to replace inefficient top management teams. However, Choi (1993) suggests that the frequency of management turnover after a takeover is much higher in conglomerate mergers than in horizontal mergers. Martin and McConnell (1991) investigated the disciplinary role of corporate takeovers with a sample of 253 successful tender offer-takeovers that occurred over the period 1958 through 1984. They found that the turnover rate for the top executive of target firms increases dramatically following successful tender offer-takeovers. During the period that begins with the announcement date of the tender offer and ends 12 months after completion of the takeover (an average of 14 months), the rate of turnover for the top executive of target firms is 41.9%, compared with an average annual turnover rate of 9.9% during the 5-year period preceding the offer. Martin and McConnell (1991) evaluated the pre-takeover performance of their sample of takeover targets. These results indicated that, on average, all takeover targets come from industries that are performing well relative to the market and that the targets of disciplinary takeovers are performing poorly within their industry, whereas, the targets of nondisciplinary takeovers are performing about as well as the average performance in their industry.

The object of this paper is to test the effect of turnover of top management on target firm's performance with the samples of Chinese listed companies. According to the literature review we have a hypothesis that the turnover of top management after a takeover will improve the performance of target firm.

2 Data sources and sample description

In this paper, the sample data of Chinese listed companies in Shenzhen and Shanghai A-share stock markets comes from CSMAR database. The turnover of top management is referred to the turnover of either chairman of board or general manager, or both of them, after the blockholder changes of the corporation. The period of sample data is from 1995 to 2001. We find total 356 cases of turnover of top management after corporate control changes of the listed companies. We choose some available data, by exclude some cases unfinished trade or having unknown data. And then, we cut all the listed companies which named ST (special traded), because these companies always have different particular characters with other listed companies. After choosing procedure, we finally keep 84 listed companies as our sample.

Tab. 1. The distribution of sample and comparison companies

Year	Number of Sample group	Number of Comparison Group
1995	1	0
1996	1	0
1997	14	3
1998	28	3
1999	22	6
2000	20	10
2001	2	23
Total	84	45

For comparing the performance with sample group, we set a comparison group with 45 listed companies. These comparison companies did not have turnover of their top management after their corporate control right change. We also get the industry performance data of all the sample and comparison companies, to exclude the influence of the industry development. Tab. 1 is the distribution of sample and comparison companies.

3 Hypotheses and methodology

When the corporate control right change of the listed company, the new blockholder will always use some methods to improve the efficient of the company actively, such as transfer assets between blockholder and this listed company; induce some new technology; integrate resources of the company; cut some employees; change the main direction of the production; change the top management, etc. So, the turnover of top management after corporate control right change, in some degree, means the determination of the new blockholder to improve the performance of target company. And changing the top management can also improve the ability of management and decision making of the target company, reducing unnecessary conflicts between new shareholder and top management. Then, top management have more accordance to execute the strategy of the new controller. Then we have two hypotheses from above analysis..

H1: The turnover of top management after corporate control right change will improve the performance of the target company.

H2: The firm that had top management turnover after corporate control right change had higher performance enhancement than the firm that hadn't had turnover of top management after corporate control right change.

To test the hypotheses, we compared the performances of the listed companies which had turnover of top management after corporate control right change with the performances before turnover of top management of the same company. For excluding the influence of the industry, we used industry-adjusted ROA and ROE. The industry code came

from the "Industry classify guidance of listed company" (China Securities Regulatory Commission, CSRC, 2001.4). And we compared the industry-adjusted performance with comparison group to find whether the turnover of top management had a significant influence with performance. And we used one-way ANOVA to test the performance variance between two different groups.

4 Results

Tab.2 is the descriptive statistic of the real performance and the industry-adjusted performance of sample group. We can find that after the turnover of top management, the ROA (return of total assets) and ROE (return of equity) increased significantly. The means of real ROA of the sample group increased from 1.23% one year before the event happened to 5.02% next year after the turnover of top management. The means of real ROE of the sample group increased from 0.46% one year before the event happened to 10.59% next year after the turnover of top management. The means of industry-adjusted ROA of the sample group increased from -3.68% one year before the event happened to 0.80% next year after the turnover of top management. The means of industry-adjusted ROE of the sample group increased from -7.35% one year before the event happened to 3.34% next year after the turnover of top management.

Tab. 2. Descriptive statistic of the real performance and the industry-adjusted performance of sample group

		Real Performance				Industry-adjusted Performance			
	N	Minimum	Maximum	Mean	Std. Deviation	Minimum	Maximum	Mean	Std. Deviation
ROA_{-1}	84	-30.63%	10.19%	1.23%	7.29%	-33.52%	6.55%	-3.68%	7.20%
ROA_0	84	-26.10%	22.18%	4.02%	8.51%	-29.09%	17.36%	-0.98%	8.09%
ROA_{+1}	84	-20.09%	20.75%	5.02%	6.37%	-22.01%	16.36%	0.80%	6.01%
ROE_{-1}	84	-70.96%	26.75%	0.46%	17.05%	-78.51%	20.71%	-7.35%	16.93%
ROE0	84	-91.19%	37.96%	6.06%	20.31%	-105.09%	29.54%	-1.93%	19.96%
ROE_{+1}	84	-33.65%	48.76%	10.59%	12.39%	-37.89%	41.53%	3.34%	11.71%

Notes: ROA-1, ROA0, ROA+1 respectively presents the ROA of last year, event year and next year of the sample group' turnover of top management happened. ROE-1, ROE0, ROE+1 respectively presents the ROE of last year, event year and next year of the sample group' turnover of top management happened.(The year of turnover of top management always the same year of the corporate control changed.)

Tab. 3. Descriptive statistic of the real performance and the industry-adjusted performance of comparison group

		Real Performance				Industry-adjusted Performance			
	N	Minimum	Maximum	Mean	Std. Deviation	Minimum	Maximum	Mean	Std. Deviation
ROA_{-1}	45	-15.56%	15.47%	2.77%	5.93%	-19.74%	9.61%	-1.77%	5.65%
ROA_0	45	-25.13%	16.63%	2.91%	5.79%	-27.28%	9.07%	-0.53%	5.46%
ROA_{+1}	45	-16.66%	13.06%	1.74%	4.87%	-18.62%	8.22%	-1.26%	4.88%
ROE_{-1}	45	-55.42%	29.68%	2.79%	13.89%	-61.99%	17.89%	-4.72%	13.48%
ROE_0	45	-68.72%	22.12%	4.60%	12.86%	-72.50%	11.67%	-0.99%	12.51%
ROE_{+1}	45	-39.32%	22.38%	2.71%	10.99%	-47.04%	14.68%	-2.19%	11.13%

Notes: ROA_{-1}, ROA_0, ROA_{+1} respectively presents the ROA of last year, event year and next year of the comparison companies' change of corporate control right happened. ROE_{-1}, ROE_0, ROE_{+1} respectively presents the ROE of last year, event year and next year of the comparison companies' change of corporate control right happened.

Tab. 4. Paired Samples Test of industry-adjusted performance of sample group

		Paired Differences				
		Mean	Std. Deviation	Std. Error Mean	t	Sig. (2-tailed)
Pair 1	ROA_{-1} - ROA_0	-0.027847274	0.103674663	0.011311833	-2.462	0.016
Pair 2	ROA_0 - ROA_{+1}	-0.009983643	0.087409891	0.009537201	-1.047	0.298
Pair 3	ROA_{-1} - ROA_{+1}	-0.037830917	0.095254735	0.010393144	-3.640	0.000
Pair 4	ROE_{-1} - ROE_0	-0.055986464	0.253803384	0.027692220	-2.022	0.046
Pair 5	ROE_0 - ROE_{+1}	-0.045348381	0.207968834	0.022691260	-1.998	0.049
Pair 6	ROE_{-1} - ROE_{+1}	-0.101334845	0.213477597	0.023292315	-4.351	0.000

Tab. 5. Paired Samples Test of industry-adjusted performance of comparison group

		Paired Differences			t	Sig.(2-tailed)
		Mean	Std. Deviation	Std. Error Mean		
Pair 1	ROA_{-1} - ROA_0	-0.001458444	0.052145990	0.007773465	-0.188	0.852
Pair 2	ROA_0 - ROA_{+1}	0.011771289	0.057225164	0.008530624	1.380	0.175
Pair 3	ROA_{-1} - ROA_{+1}	0.010312844	0.071968092	0.010728370	0.961	0.342
Pair 4	ROE_{-1} - ROE_0	-0.018086200	0.157152567	0.023426922	-0.772	0.444
Pair 5	ROE_0 - ROE_{+1}	0.018866178	0.148340597	0.022113311	0.853	0.398
Pair 6	ROE_{-1} - ROE_{+1}	0.000779978	0.185904128	0.027712951	0.028	0.978

Tab.3 is the descriptive statistic of the real performance and the industry-adjusted performance of **co**mparison group. The means of real ROA of the comparison companies increased slightly from 2.77% one year before the event happened to 2.91% event year, and then decreased to 1.74% next year after the corporate control right changes. The means of real ROE of the comparison companies increased from 2.79% one year before the event happened to 4.60%, and then decreased to 2.71% next year after the corporate control right changes. The means of industry-adjusted ROA of the comparison companies increased from -1.77% one year before the event happened to -0.53%, and then decreased to -1.26% next year after the corporate control right changes. The means of industry-adjusted ROE of the comparison companies increased from -4.72% one year before the event happened to -0.99%, and then decreased to -2.19% next year after the corporate control right changes.

Comparing the performances of sample group and the comparison group, we find that the performance of sample group have significant increased; but the performance of comparison group haven't had some increment, even had some decrease. The industry-adjusted ROE of sample group surpassed the average level of industry the year after the turnover of top management. But the industry-adjusted ROE of comparison group was under the average level of industry the year after the corporate control right changes. So we can conclude that companies which had the turnover of top management after corporate control right changes will have better performance improvement than those which hadn't change their top management after corporate control right changes.

Tab.4 is the paired samples test of industry-adjusted performance of sample group. From the Tab.4, we can find that the means of industry-adjusted performance of all the pairs are significant different at level 0.05, except pair 2 (ROA_0 - ROA_{+1}).

Tab.5 is the paired samples test of industry-adjusted performance of comparison companies. From the Tab.5, we can find that the means of industry-adjusted performance of all the pairs are not significant different at level 0.05.

These two tables show that the turnover of top management after corporate control right changed improved the performance of the target company significantly. And the companies which did not have turnover of top management after corporate control right changed, had not had their performance improved significantly. So the hypothesis 1 passed the test.

Tab.6 shows the results of the One-Way ANOVA of industry-adjusted performance of sample group and comparison group. Through comparing the differences of "between groups" and "within groups", we can test whether the performance is the same between sample group and comparison group. According to the result showed in the Tab.6, we can find that ROA_{+1} is significant at 5% level (5.1%, very close), and ROE_{+1} is significant at 1% level. So the ROA_{+1} and ROE_{+1} between sample group and comparison group have great differences, this difference comes from whether they change their top management.

ROA_{-1}, ROA_0, ROE_{-1}, ROE_0 are not significant. That means there are not significant performance differences between sample group and comparison group in the year before the event, and the year the event happened. Because the effects of the turnover of top management were showed next year after the new team came. So the hypothesis 2 partly passed the test.

Tab. 6. One-Way ANOVA of Industry-adjust performance between sample group and comparison group

	Industry-adjusted performance			
	Sum of Squares	Mean Square	F	Sig.
ROA_{-1}	0.011	0.011	2.359	0.127
ROA_0	0.001	0.001	0.108	0.743
ROA_{+1}	0.012	0.012	3.887	0.051
ROE_{-1}	0.020	0.020	0.812	0.369
ROE_0	0.003	0.003	0.082	0.775
ROE_{+1}	0.090	0.090	6.757	0.010

5 Conclusion

In this paper, we use the samples which come from the listed companies of Shenzhen and Shanghai A-share stock markets which had turnover of top management after the corporate control rights changed. We used the industry-adjusted ROA and ROE to test the changes of performance after turnover of top management. Through the paired samples test of industry-adjusted performance of sample and comparison companies, we find that the turnover of top management after corporate control right changed improved the performance of the target company significantly. But the companies which did not have turnover of top management after corporate control right changed, had not had their performance improved significantly. We also used the One-Way ANOVA to test whether there have some differences of performance improvement between sample group and comparison group.

The result is that the company which had turnover of top management after the corporate control rights changed, had significant performance improvement, and had better performance than the company which had not had turnover of top management after the corporate control rights changed.

The further research of this issue is recommended to use other methods to test the hypotheses, such as event study method, and to find the factors that influence the efficient of companies which change their top management after their corporate control right changed.

References

1. Bruce A. Samuelson, Craig S. Galbraith, J.W.M., Organizational Performance and Top-Management Turnover. Organization Studies, 1985. 6(3): p. 275-291.
2. Bluedorn, A.C., A Unified Model of Turnover from Organizations. Human Relations, 1982. 35(2): p. 135-153.
3. Buono, A. F & Bowditch, J.L., The human side of mergers and acquisitions. 1989, San Francisco: CA: Jossey-Bass.
4. Choi, Y., The choice of organizational form, the case of post-merger managerial incentive structure. Financial Management, 1993. 22: p. 69-81.
5. Cannella, B. & Hambrick, D., Succession as a sociopolitical process: Internal impediments to outsider selection. Academy of Management Journal, 1993. 36(4): p. 733-762.
6. Kenneth J. Martin, J.J.M., Corporate performance, corporate takeovers, and management turnover. Journal of Finance, 1991. XLVI(2).
7. Mark R. Huson, Robert Parrino, A.L.T.S., Internal Monitoring Mechanisms and CEO Turnover: A Long-Term Perspective. Journal Of Finance, 2001. LVI(6): p. 2265-2297.
8. Mobley, W.H., et al., Review and Conceptual Analysis of the Employee Turnover Process. Psychological Bulletin, 1979. 86: p. 493-522.
9. Porter, L. W., & Steers, R.M., Organizational, work, and personal factors in employee turnover and absenteeism. Psychological Bulletin, 1973. 80: p. 151-176.
10. Price, J.L., The Study of Turnover. 1977, Ames, IA: Iowa State University Press.
11. Ravenscraft, D. J., &Scherer, F., M-Mergers and managerial performance, in J. C. Coffee, Jr., L. Lowenstein & S. Rose-Ackerman (Eds.), Knights. raiders, and targets: The impact of the hostile takeover. 1988, Oxford University Press: New York. p. 194-210.
12. Schweiger, D. M & DeNisi, A.S., Communication with employees following a merger: A longitudinal field experiment. Academy of Management Journal, 1991. 34: p. 110-135.
13. Schweiger, D. M., & Walsh, J., Mergers and acquisitions: An interdisciplinary view in research in personnel and human resource management, in K. Rowland & G. Ferris (Eds.), Research in personnel and human resource management. 1990, CT: JAI Press Inc.: Greenwich. p. 41-107.
14. Walsh, J., Top management turnover following mergers and acquisitions. Strategic Management Journal, 1988: p. 73-183.