

IPO AND CEO TURNOVER: AN EMPIRICAL ANALYSIS ON ITALY AND UK

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Abstract

This work is aimed at investigating the factors that can foster CEO turnover, being acknowledged as one of the most crucial events in a firm's life. The study examines CEO turnover before and after the IPO process, looking at firms going or recently gone public, with a specific focus on the effect of performance and the institutional context. The empirical analysis is based on a sample of non-financial companies listed on the Italian Stock Exchange and the London Stock Exchange in the period 2000-2009.

Keywords: CEO; IPO; CEO turnover; Institutional Theory

GEL Classification: G23; G34; N20; O16; M10

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1. INTRODUCTION

The academic debate on corporate governance has been mostly focused on institutional factors (Shleifer and Vishny, 1997; Denis and McConnell, 2003; Durnev and Kim, 2005), on ownership structures (He and Sommer, 2011), and on governing bodies (Daily and Dalton, 1992; 1993). With regard to governing bodies, one of the most important issues that firms have to face is the turnover of the Chief Executive Officer (hereinafter CEO), as it represents an important element of discontinuity in a firm's life (Barrett, 2011). Given the importance of CEO's decisions (Wasserman, 2003), especially in terms of responsibility for financial and economic performance (Bertrand and Schoar, 2003), extant literature has investigated the potential reasons underpinning CEO turnover, whereby firm's performance has emerged as a dominant driving force (Shen and Cannella, 2002a). The effects of performance, however, may vary during the lifecycle of a firm as well as across different contexts. In the period around the initial public offerings (IPOs) firms typically have to deal with significant economic and competitive pressures, driven by the change and the fragmentation of key stakeholders (Nguyen, 2011). Similarly, the legal and regulatory mechanisms that affect CEO turnover are different across countries. In addition, because extant studies on CEO turnover are mostly focused on listed companies located in the USA, some peculiarities may have been overlooked.

This study aims to contribute to governance literature by investigating CEO turnover around the period of IPO (Beatty and Zajac, 1994) in different contexts. Consistent with this purpose, we have performed a longitudinal analysis on the determinants of CEO turnover, based on a dataset of companies that have gone public between 2000 and

2009 in Italy and UK. These two countries provide an ideal setting as they are representative of the Latin and the Anglo-Saxon contexts respectively. The article is structured as follows: first, a review of the literature is provided with the aim of identifying the research gaps from which our research hypotheses are formulated. Afterwards, the methodology section describes the sample, the main variables along with the estimation method. Finally, results of the empirical analysis are discussed and conclusions are drawn.

2. LITERATURE REVIEW AND HYPOTHESES

CEOs have been largely investigated in the literature due to their critical role in actively pursuing opportunities and controlling firm's strategy and structure (Wasserman, 2003). In particular, CEOs have been identified as decision makers whose choices can determine firms' performance (Finkelstein and Hambrick 1990; Daily and Dalton, 1993; Waldman et al. 2001; Bertrand and Schoar, 2003). Both the Upper Echelons Theory and leadership theories have indeed emphasized that top managers shape firm strategies and performance (Hambrick and Mason, 1984; Finkelstein and Hambrick, 1990, 1996) according to their set of experiences, skills and values (Graffin et al., 2011). At the same time, the Agency Theory (Jensen and Meckling, 1976) has highlighted the existence of conflicts of interests between ownership and management, which however can be solved through the implementation of corporate governance practices (Gomez-Mejia et al., 2001; Burton et al., 2004). Thus, the importance of the CEO explains the academics' and practitioners' interest in CEO turnover (Wiersema, 1992, 2011), which represents a common although disruptive event in corporate governance (Kesner and Sebora, 1994; Barrett, 2011).

CEO turnover has increased in recent years (Wiersema, 2002; Allgood and Farrell, 2003; Wiersema and Zhang, 2011; Kaplan and Milton, 2012; Jenter and Kanaan, 2015), even shortly after the appointment (Zhang, 2008) and extant research has analyzed both the determinants and the consequences of CEO turnover (Kesner and Sebor, 1994), focusing mostly on environmental pressures, corporate performance, personal reasons, and changes in the ownership structure.

The consequences of CEO turnover have been studied in terms of both financial (Denis and Denis, 1995) and strategic performance (Shen and Cannella, 2002a; Wiersema and Zhang, 2011), as well as with reference to successor's appointment (Cannella and Shen, 2001; Shen and Cannella, 2002a; Shen and Cannella, 2002b; Bhagat et al., 2010; Nakauchi and Wiersema, 2015).

A larger body of research has however been devoted to the analysis of factors that may encourage CEO turnover, among which three main determinants have been identified, namely financial performance (Coughlan and Smith, 1985; Warner et al., 1988; Weisbach, 1988; Bruton et al., 2000; Fee and Hadlock, 2004), strategic reasons (Boivie et al., 2012), and personal motivations, such as compensation, career opportunities, and private reasons (Beatty and Zajac, 1994; Gao and Li, 2010). The achievement of financial performance results below expectations is acknowledged as the main driving force of CEO turnover (Coughlan and Schmidt, 1985; Arthaud-Day et al. 2006; Boivie et al., 2012). The role of performance in determining CEO turnover has been studied in relation to both firms' characteristics, e.g. industry, size, shareholders (Wasserman, 2003; Anderson and Reeb, 2003; Nguyen, 2011), and CEO personal characteristics and competences (Ocasio, 1994; Shen and Cannella, 2002b; Bhagat et al., 2010). Furthermore, the relationship between CEO turnover and financial performance has been analyzed in relation to critical situations, such as corporate crises (Gabarro, 1987), corporate misconduct (Wiersema and Zhang, 2011), or strategic re-orientation (Nakauchi and Wiersema, 2015).

Recent studies have shown that CEO turnover may result from the interaction of several factors, such as financial analysts' forecasts (Wiersema and Zhang, 2011) and industry dynamics (Jenter and Kanaan, 2015). Significant attention has been given to ownership, specifically with regard to concentration and changes (Nelson, 2003; Nguyen, 2011), as well as to family firms (Anderson and Reeb, 2003; Burton et al., 2004; Pérez-González, 2006) and to the separation between ownership and management (Nelson, 2003; He and Sommer, 2011).

Although extant literature has analyzed in depth CEO turnover, most research has been focused only on listed firms (Warner et al., 1988; Welbourne, 1999; Yang et al., 2011). This study therefore intends to investigate the impact of IPO on CEO turnover, through an analysis of companies in the period around their IPO. The IPO indeed represents one of the milestones in a firm's life, as it

allows to obtain the necessary resources for growth (Certo et al., 2009), while simultaneously involving a progressive restructuring (Certo 2003; Higgins and Gulati, 2006). Therefore, despite the listing process is widely regarded as a success from a CEO's viewpoint (Bach and Smith, 2007; Latham and Braun, 2010), such process may increase CEO turnover likelihood (Nelson, 2003). Specifically, some studies have demonstrated that CEO turnover subsequent to IPO can be attributed to the presence of new shareholders, the increasing short-term pressures on top management, and to the lack of ties with the new shareholders' composition (Daily and Dalton, 1992, 1993; Latham and Braun, 2010). As the period around the IPO is characterized by high competitive pressures on financial performance results, CEOs in listed companies may be subject to greater pressures and, because of unsatisfactory financial performance results, CEO turnover may be more likely than in unlisted companies. We therefore formulate the following hypothesis:

H1a: The likelihood of CEO turnover is greater after IPO.

H1b: The negative relationship between performance and CEO turnover is stronger after IPO.

Although most studies have focused on U.S. public companies (Nelson, 2003; He and Sommer, 2011), many contributions have been devoted to how corporate governance choices vary across different national contexts (La Porta et al., 2000; Aguilera and Jackson, 2003; Klapper and Love, 2004; Aguilera et al., 2008).

Literature on the topic has documented significant differences among countries in terms of corporate legislation, ownership concentration, capital market structure, and access to investments (La Porta et al., 1998), which carry implications also for corporate governance models (La Porta et al., 2000). Thus, ownership concentration is usually higher in Latin countries (Hoskisson et al., 2002), where a direct relationship between ownership and management tends to be more likely (Hoskisson et al., 2004; Fiss and Zajac, 2004; Lerner and Schoar, 2005). Although Agency theory has shown that ownership concentration reduces the risk of opportunistic behavior (Bruton et al., 2010), in Latin countries it implies a greater tolerance for unsatisfactory results (La Porta et al., 2000, Gomez-Mejia et al.; 2001). Conversely, investors in Anglo-saxon countries evaluate top managers mostly on financial performance (Prowse, 1990), have higher possibilities to contrast opportunistic behaviors, and to express their opinions on major corporate decisions (La Porta et al., 2000).

Based on these arguments, we expect a greater attention to performance in Anglo-Saxon countries if compared to Latin countries, resulting in a stronger negative relationship between performance and CEO turnover in the former if compared to the latter. We therefore formulate the following hypotheses:

H2a: CEO turnover is more likely in Anglo-Saxon countries if compared to Latin countries.

H2b: In Anglo-Saxon countries the negative relationship between performance and CEO turnover is stronger if compared to Latin countries.

3. METHODOLOGY

3.1. Sample and Data

This study aims at analyzing the impact of IPO on CEO turnover in different contexts, focusing on Latin and Anglo-Saxon countries. A comparison is proposed between the Italian context as an exemplification of Latin countries, although so far only scarcely considered (Depperu et al., 2013; Minichilli et al. 2014), and the British one, representative of the Anglo-Saxon context. (Filatotchev, 2006).

The sample is composed by non-financial companies that went public on the Italian and on the London Stock Exchange in the period 2000-2009. The decision to exclude financial firms from the dataset is due to their specificities which hamper the comparison with other companies in terms of governance structure (Gao and Jain, 2012).

In the period 2000-2009, 118 companies went public in Italy, and 299 in the UK. For each firm, we collected data on CEO turnover, financial performance, size and sector of activity over a seven years-timeframe, i.e. the year of the IPO, and the three years before and after the IPO. The choice of analyzing a ± 3 years' timespan since listing is justified by the objective of ensuring homogeneity in the sample in terms of 'comparability' between public and private companies. Indeed, while many

studies examining the effects of IPO evaluate the trends of the market value (Gao and Jain, 2012; Jiang and Li, 2013), this research takes into consideration the dynamics of CEO turnover within a significantly wider timespan (Amore et al., 2011). Thus, the sample is composed by private companies about to go public (three years before IPO) and newly listed companies (no more than three years after IPO).

Data have been collected from ORBIS database (Bureau van Dijk) and from the online archives of the Italian and British Stock Exchange. Due to the difficult access to data for private companies (especially data on performance), the total number of observations is 1157, corresponding to 300 companies (115 from Italy and 185 from the UK).

3.2. Variables, measures and estimation method

3.2.1. Dependent variable

The dependent variable is the likelihood of CEO turnover. This variable has a dichotomous nature, where value 1 indicates that the CEO has changed during the observed year, and 0 if it did not change. CEO turnover has been considered valid when certain and completed, i.e. only after leaving his/her position. The total number of CEO turnover, by year and by country, is shown in Table 1. In the United Kingdom, most of the turnover occurred in the same year of listing (60 out of a total of 110), whereas in Italy most turnovers are distributed in the years following the listing.

Table 1. CEO Turnover by country and year

	3 years before IPO	2 years before IPO	1 year before IPO	IPO Year	1 year after IPO	2 years after IPO	3 years after-IPO	Total
Italy	1	6	5	9	19	14	23	77
United Kingdom	1	11	27	60	4	7	0	110
Total	2	17	32	69	23	21	23	187

3.2.2. Independent variable

The independent variables include financial performance, IPO, and institutional context.

In line with previous studies (Friedman and Singh, 1989; Maury, 2006; Bennedsen et al., 2007; Kaplan and Milton, 2012), we measured financial performance through two commonly used (Kaplan and Milton, 2012) industry-adjusted measures, namely return on equity (ROE - calculated as net profit/equity), and return on assets (ROA - calculated as the ratio of operating income to total assets). The effect of these variables is lagged, so that the likelihood of CEO turnover in year t is based on the performance in year $t-1$.

The difference between pre- and post-IPO period is measured through a dichotomous variable (IPO) which takes value 1 if the firm is already listed, and 0 if it is not.

The institutional context is captured through a dichotomous variable (Anglo-Saxon), where 1 indicates that the firm is headquartered in the UK, and 0 that it is in Italy. Hypotheses 1b and 2b are tested introducing into the model two interaction

terms, i.e. 'performance * IPO' and 'performance * Anglo-Saxon' respectively.

3.2.3. Control variables

We included a control variable capturing firm size, measured as the log-transformed number of employees to reduce the asymmetry of its distribution.

Since the period covered by the analysis includes the years 2008 and 2009, in which the global crisis had a profound impact on the global economy, a dichotomous variable has been introduced in the analysis (Financial crisis), which takes value 1 for observations falling crisis in 2008 or subsequent years, and 0 otherwise.

Finally, we controlled for differences across ten industries based on the Global Industry Classification Standard (GICS). Nine dichotomous variables have been therefore included, using 'consumer goods' as baseline category.

Table 2 shows the variables and measures used in the study.

Table 2. Variables and measures

Variables	Measures
<i>Dependent variable</i>	
CEO turnover	= 1 if the CEO was replaced during the year (year t) = 0 otherwise
<i>Independent and control variables</i>	
Financial performance	- ROE (net profit / equity) in the year t-1 - ROA (operating income / total assets) in the year t-1
Listing	= 1 if the firm is listed = 0 if the firm is not listed
Anglo Saxon Context	= 1 if the firm is located in the UK = 0 if the firm is located in Italy
Firm size	Number of employees (natural logarithm)
Financial crisis	= 1 if the observations fall in 2008 or subsequent years = 0 otherwise
<i>Industry dummies</i>	
Basic materials	= 1 if the firm operates in the basic materials sector = 0 otherwise
Consumer services	= 1 if the firm operates in the consumer services sector = 0 otherwise
Finance	= 1 if the firm operates in the financial services sector = 0 otherwise
Health	= 1 if the firm operates in the health sector = 0 otherwise
Industrial goods	= 1 if the firm operates in the industrial goods sector = 0 otherwise
Oil & Gas	= 1 if the firm operates in the oil and gas sector = 0 otherwise
Technology	= 1 if the firm operates in the high-tech goods sector = 0 otherwise
Telecom	= 1 if the firm operates in the telecommunications sector = 0 otherwise
Utilities	= 1 if the firm operates in the utilities sector = 0 otherwise

The set of nine dichotomous industry variables measures the difference compared to the consumer goods industry, chosen as baseline

3.2.4. Estimation Method

An econometric analysis was carried out to test the hypotheses related to the effect of IPO and institutional context on CEO turnover. In line with the dichotomous nature of the dependent variable, a logit model was performed (Verbeek, 2004). It should also be noted that because more

observations are related to the same companies (1157 observations are associated with 300 companies), error terms may not be independent from one another. Multiple observations from the same company are controlled by 'clustering' the error terms by company. In summary, the model described above assumes the following specification:

$$\text{logit}(\pi) = \beta_0 + \beta_1 \text{PERFORMANCE} + \beta_2 \text{IPO} + \beta_3 \text{ANGLO-SAXON} + \beta_4 \text{SIZE} + \beta_5 \text{FINANCIAL_CRISIS} + \beta_6 (\text{PERFORMANCE} * \text{IPO}) + \beta_7 (\text{PERFORMANCE} * \beta_4 \text{ANGLO-SAXON}) + \text{INDUSTRY DUMMIES} \quad (1)$$

where, π is the likelihood of CEO turnover.

4. RESULTS AND DISCUSSION

Table 3 displays the results of the econometric analysis. Columns 1 and 2 show results for models based on ROE as a performance measure, whereas in columns 3 and 4 performance is measured by ROA¹. In columns 1 and 3 only the direct effects are tested, while in columns 2 and 4 the interaction terms of 'performance * IPO' and 'performance * Anglo-Saxon' are added.

As long as control variables are concerned, firm size does not have a statistically significant effect, thus suggesting that CEO turnover is transversal across enterprises². 'Financial crisis' has a negative

and statistically significant effect on CEO turnover ($p < 0.05$, column 2), indicating that in times of greater uncertainty and hostile environment, as is the case of the recent economic crisis, companies tend to have a 'conservative behavior' and grant continuity to the top management. In addition, no statistically significant relationships were found between the industry dummies and the likelihood of CEO turnover.

In line with previous studies (Coughlan and Smith, 1985; Shen and Cannella, 2002a), our results confirm that performance has a negative and statistically significant effect for both measures of performance (Table 3, $p < 0.01$). Financial performance is, indeed, a crucial element determining the stability of top managers, as better performance is typically associated with a lower probability of CEO turnover.

¹ As data on ROA were not available for most of observed firms, the number of observation is considerably smaller than in the model with ROE.

² As an alternative to the number of employees, the logarithm of total assets has been used as a measure of size, but as such data are not available for many firms, this would significantly decrease the number of observations. However, there are not significant differences in the results obtained with the two different measures of size.

Table 3. Logit Estimates - Dependent Variable = Likelihood of CEO Turnover

<i>Independent Variables</i>	(1)	(2)	(3)	(4)
Basic materials	-.17 (-.44)	-.05 (-.14)	-.01 (-.02)	-.01 (-.03)
Consumer services	-.52 (-1.61)	-.48 (-1.49)	-.46 (-1.28)	-.44 (-1.25)
Finance	.23 (.38)	.29 (.48)	.23 (.38)	.21 (.34)
Health	-.33 (-.93)	-.25 (-.70)	-.21 (-.54)	-.20 (-.50)
Industrial goods	-.22 (-.79)	-.14 (-.51)	-.28 (-.89)	-.26 (-.84)
Oil & Gas	.33 (.94)	.36 (1.00)	.39 (1.03)	.41 (1.09)
Technology	-.09 (-.30)	-.07 (-.24)	-.02 (-.06)	-.01 (-.04)
Telecommunications	-.05 (-.13)	-.005 (-.01)	.13 (.31)	.19 (.43)
Utilities	-.16 (-.45)	-.12 (-.35)	-.15 (-.39)	-.12 (-.32)
Financial crisis	-.52* (-1.88)	-.62** (-2.30)	-.47 (-1.61)	-.46 (-1.58)
Firm size	.001 (.02)	.01 (.026)	-.02 (-.53)	-.02 (-.43)
Performance (ROE)	-.001*** (-3.64)	-.02*** (-3.60)		
Performance (ROA)			-.01*** (-2.65)	-.02** (-2.20)
IPO	1.09*** (5.39)	1.04*** (5.03)	.64*** (2.95)	.63*** (2.87)
Anglo-Saxon	.73*** (3.50)	.69*** (3.30)	.66*** (3.01)	.67*** (3.00)
Performance (ROE) * IPO		-.001 (-.16)		
Performance (ROE) * Anglo-Saxon		.01*** (3.05)		
Performance (ROA) * IPO				.001 (.04)
Performance (ROA) * Anglo-Saxon				.02** (1.96)
Constant	-2.54*** (-7.16)	-2.43*** (-6.68)	-2.00*** (-5.16)	-1.99*** (-5.10)
Number of Observations	1157	1157	912	912
χ^2	64.43***	73.62***	46.08***	49.36***
Pseudo R ²	.07	.08	.05	.05

Note: z-statistics in parentheses; * $p < .10$, ** $p < .05$, *** $p < .01$

The empirical analysis supports Hypothesis 1a: the statistically significant and positive coefficient ($p < 0.01$ in all models) suggests that the likelihood of CEO turnover is greater after the IPO because of the stronger pressures coming from a variety of stakeholders (Nelson, 2003) focused on short-term results (Latham and Braun, 2010).

Hypothesis 2a about the influence of the institutional context is supported as well ($p < 0.01$ in all models): in the UK, as representative of the Anglo-Saxon context, there is a greater likelihood of CEO turnover if compared to Italy, example of a Latin country. Indeed, the United Kingdom is characterized by the existence of mechanisms and practices that promote greater shareholders' protection and direct assumption of responsibility by the top managers, thereby fostering top management dynamism.

When considering indirect effects, Hypothesis 1b suggests that the negative relationship between financial performance and CEO turnover is stronger after IPO. The interaction term 'Performance * IPO' is however not statistically significant for any of the two performance measures used, failing to support Hypothesis 1b. This result can be explained by the fact that performance is a strong determinant of

CEO turnover, regardless of whether a firm goes public.

The results of the interaction between performance and institutional context contradicts Hypothesis 2b, i.e., that in Anglo-Saxon contexts (the UK in our case) the effect of performance on the likelihood of CEO turnover is greater than in Latin ones (Italy in our case). The coefficient of the interaction term 'Performance * Anglo-Saxon' indeed is positive and statistically significant for both performance measures (ROE, column 2, $p < 0.01$; ROA, column 4, $p < 0.05$). In contrast with our prediction that performance could strengthen CEO turnover in the UK, our findings suggest that the relationship between performance and CEO turnover is weaker in the UK. Thus, the negative relationship performance-CEO turnover is mitigated rather than strengthened, and this can be explained by considering that in a more dynamic market, such as the UK, additional factors may explain CEO turnover. In the Anglo-Saxon contexts, it is more likely to have a 'market of top managers', which encourages firms as well as top managers to be more dynamic. Thus, CEO turnover in the UK can be explained not only by financial performance, but also by the active role of shareholders as well as of the increased incidence of personal motivations.

5. CONCLUSIONS

This study aims to contribute to the conversation on changes in corporate governance by analyzing the factors that can foster CEO turnover. While previous studies have explained CEO turnover looking at performance, ownership structure, board composition, and CEOs' personal characteristics, this study focuses on how the relationship between performance and CEO turnover is moderated by other variables. In particular, we focused on the impact of IPO, which has been analyzed considering firms in the period immediately before and after going public. For this purpose, a sample of companies that have gone public in the last decade has been selected, considering also two different institutional settings (Italy and the United Kingdom) to assess the effect of the institutional environment.

The contribution of this paper therefore stems from the observation of the phenomenon of CEO turnover in a specific phase of firms' lifecycle, enriched by the adoption of an institutional perspective. The empirical analysis confirmed that the likelihood of CEO turnover is significantly greater a) after the IPO, and b) in Anglo-Saxon contexts, but independently from performance. Our results should be interpreted in the light of the characteristics of the sample. While it includes firms that went public in the decade 2000-2009 and therefore is representative of firms undergoing a crucial event like IPO, our sample may limit the generalizability of our results. In our analysis, in fact, private companies are intended as companies 'next to the listing', while those listed are 'newly listed companies'.

This study also provides several managerial implications, especially for managers belonging to firms about to go public or considering doing so. Companies willing to go public are generally aware of the changes subsequent to the IPO, in terms of management practices and tools required to effectively communicate with a variety of stakeholders. This study shows, however, that after an IPO firms undergo a more dynamic phase, which results in a higher probability of CEO turnover. This could be relevant for the decision of whether and when to go public and should, therefore, be considered among the non-monetary costs related to the IPO that managers and entrepreneurs are required to evaluate.

Our analysis has several limitations, which may represent potential avenues for future research. First, because the analysis was made considering only two countries albeit representative of Anglo-Saxon and Latin contexts, it would be interesting to extend the study to other contexts and select companies with different characteristics if compared to those in our sample. In addition, among the factors that can lead to CEO turnover, our study does not examine the need for new skills or radical strategic changes (Westerberg and Wincent, 2008), or the reasons related to the personal characteristics of CEOs, who might be interested in a different or better job after the IPO, or even willing to retire. This type of information is however extremely difficult to gather, especially when companies are not yet public, and it is actually marginal to the scope of our study, which aims to analyze the effects of IPO in different institutional

contexts. Future studies could therefore analyze more in depth the different reasons of CEO turnover, especially strategic and personal motivations. Finally, this study only indirectly considers the impact of factors related to ownership and governance structure, which could be included in future studies in order to have a more comprehensive overview of the circumstances underpinning CEO turnover.

At the methodological level, the study measured the financial performance mostly through profitability measures, although extant literature proposed the use of multiple measures. However, the nature of our sample, especially with regard to private companies, prevented us from using other financial data as well as additional data on firm governance and ownership structures. Future studies might hence try to overcome this issue by collecting primary data on private companies.

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