



Does CEO Turnover Matter? Empirical Evidence from the Philippines

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ABSTRACT

This study investigated the market reaction to announcements of CEO turnovers in Philippine-listed companies between January 2008 and December 2018. Turnovers were classified concerning successors' origin (internal versus external), turnover type (forced versus voluntary), and successors' gender (male versus female). Event study methodology using the market model was employed to analyze the hand-collected sample of 136 CEO turnover announcements. Market reaction was significantly positive for internal, external, and voluntary turnover. The market reaction, however, was found to be significantly negative in the case of forced turnover. Similarly, concerning the gender difference, the result showed that market reaction was significantly negative for female CEO appointments and significantly positive for male CEOs. The results provide strong evidence that new CEOs' selected attributes and the turnover's characteristics are factors that have the explanatory power on the investor's reaction. The contributions of this study to the literature are threefold. First, it serves as the first empirical evidence of market reaction to CEO turnover from the Philippines emerging market. This study also confirms the finding of the previous studies on CEO turnover by looking into several turnover categories, namely external, internal, forced, and voluntary. Finally, it enriches the limited empirical evidence on the CEOs' gender effect on abnormal return surrounding the turnover announcement date.

Keywords: CEO Turnover, Market Reaction, Abnormal Return, Market Model, Event Study.

INTRODUCTION

The chief executive officer (CEO) is considered to be the critical strategic decision-maker in every organization. The role of CEOs is critical as the decisions they make reflect in the organization as a whole (Hambrick & Mason, 1984). A CEO turnover, therefore, represents a major event in an organization's history and could have a significant impact on the company and its stakeholders. This paper investigates the reaction of the Philippines stock market to announcements of CEO turnovers of a listed firm from January 2008 to December 2018.

CEO turnover is one of the most critical corporate decisions (Huson, Parrino, & Starks, 2001; Chen, Cheng, & Dai, 2013) because it triggers a structural change in some aspects of the

organization. For example, it facilitates a new leadership style that promotes a reorganization (Romanelli & Tushman, 1994). Furthermore, change in CEO can alter the existing power structures (Boeker, 1997), influences the direction of the organization through redesigning the administrative framework (Miller, Droge, & Toulouse, 1988). CEO turnover also triggers new strategic conduct to better align the organizational behavior of the firm with environmental dynamics (Pfeffer & Salancik, 2003; Hillman, Withers & Collins, 2009). Furthermore, this change could also influence the external environment, such as economic and political conditions (Brady & Helmich, 1984). This study focuses only on the effect of CEO turnover on the shareholder's wealth.

CEO turnover can occur due to several reasons, the most common of which are reassignment, retirement, mortality, dismissal, or replacement due to some reasons (Furtado & Karan, 1990; Messersmith, Lee, Guthrie, & Ji, 2014). Another reason could also be a formality to signal the external party about management's commitment to correcting the poor performance of the firm (Zhang & Wiersema, 2009; Voussemer et al., 2013). This study classifies turnovers concerning the exit type of the CEO (voluntary or forced), the origin of the incoming CEO (internal or external), and the successor gender.

This study aims to examine how investor responds to the information about CEO turnover. The expectation is that the investors' reaction to the changes in the market value of the company's stock will be reflected in the abnormal return surrounding the event date (i.e., the announcement of CEO turnover). To investigate the market reaction standard event study methodology was applied (Fama & French 1993; McWilliams & Siegel 1997; Lyon, Barber, Tsai 1999). The analysis of a sample of 136 CEO turnover announcements indicated that voluntary turnover, external, internal, and male successor yielded a significantly positive average abnormal return for the [-2, 2], [-3, 3], and [-5, 5] event windows. A significantly negative average abnormal return, however, was detected for forced turnover and female successor.

Previous researches on investor reaction to the announcement of CEO turnover based on developed country data has shown mixed results. Some studies found a significantly positive market reaction (Denis & Denis, 1995; Kang & Shivdasani, 1995; Borokhovich, Parrino & Trapani, 1996; Huson, Malatesta & Parrino, 2004; Adams & Mansi, 2009). Other studies detected a significantly negative market reaction (Kaplan, 1994; Conyon & Florou, 2002; Dedman & Lin, 2002; Suchard, Sing, & Barr, 2001). Additionally, some studies found no significant reaction (Reinganum, 1985; Warner, Watts, & Wruck, 1988; Anderson, Jayaraman,

& Mandelker, 1992). Hence, it is interesting to investigate whether the same would apply in a developing country setting such as the Philippines.

The contributions of this study to the literature are threefold. First, it provides the first empirical evidence of the market reaction to CEO turnover from the Philippines emerging market. Furthermore, this study confirms the findings of the previous studies on CEO turnovers by looking into several turnover categories, namely, external, internal, forced, and voluntary. Finally, it adds to the scarce empirical evidence on the CEO's gender effect on abnormal return surrounding turnover announcement date.

LITERATURE REVIEW

The Efficient Market Hypothesis

The efficient market hypothesis (EMH) theory posits that in markets characterized by a sufficiently large number of rational investors, with no entry or exit barriers, actual prices of a security fully reflects in all information that is known by the investor (Fama, 1991). Every investment decision made by an investor such as sell, buy, or hold security will trigger a change in the actual market value of a particular security and to the market share price index according to the mechanism that applies in the market where the securities are traded.

EMH assumes that investors behave rationally by trying to maximize profits and actively compete by predicting the market value for each security. One of the conditions that will make this possible is that all market participants know all relevant information. Competition among investors in an efficient market brings in certain situations where the actual price of the securities reflects information about the event that has occurred and information about the event expected to happen (Fama, 1991). In other words, it will arrive at a particular time where the actual price of a security will summarize the intrinsic value of the securities.

In the context of this study, the CEO turnover announcement is potentially causing a market reaction. The reaction would depend on the investor's perception of the CEO turnover, whether they see it as a piece of good news or bad news.

The event view of CEO turnover

As proposed by Friedman and Singh (1989), there are three event views in the literature, which are related to CEO turnover, namely inconsequential, adaptive, and disruptive event views.

First, the inconsequential event view predicts that the announcement of CEO turnover is insignificant and raises no investors' expectations about the firm's prospect. From this view, organizational performance is affected by a random factor in the environment instead of the

CEO's ability or other management efforts. Consequently, CEO turnover will have an insignificant effect on the firm's performance (Bommer & Ellstrand, 1996). The inconsequential event view is supported by the scapegoat hypothesis (Gamson & Scotch, 1964), which predicts that CEO turnover announcement no abnormal returns in a firm's stock price on news of CEO turnover. This theory views that all new CEOs possess similar abilities with the predecessor and firm performance; therefore, CEOs are contingent not only on management action but also another factor beyond their control, which is commonly referred to as the random factor (Friedman & Singh, 1989). In other words, the scapegoat hypothesis states that the CEO turnover acts as a symbolic action, not as a signal for improvement in managerial quality. Hence, the scapegoat hypothesis predicts an insignificant market reaction on news of the CEO turnover.

From the adaptive view, the CEO turnover is the way organizations align resources by adjusting to the changing environmental requirements (Friedman & Singh, 1989). In its strongest form, the adaptive view predicts that the CEO turnover announcement will affect investors' expectations about the firm's prospects. The reason is that the investor perceived that the CEO turnover as a change toward environmental demand, which is beneficial for the firm's prospects. Top management, including the CEO, has the power and control over organizational performance and will be able to learn from past poor performance or the mistakes made (Friedman & Singh, 1989; Reinganum, 1985). Thus, the CEO turnover is viewed as corrective strategy executed by the management to signal the external party about their commitment to address and correct the company's poor performance (Voussemer et al., 2013; Zhang & Wiersema, 2009).

The disruptive event view, on the other hand, postulates that any change inside a company leads to a decline in overall company's performance that may lead to more severe conditions include company closure (Friedman & Singh, 1989; Hannan & Freeman, 1977). CEO turnover is considered a significant change in an organization which increases the likelihood of organizational death. The disruptive event view assumes that the environments surrounding a company are stable, and CEO turnover is viewed as a fundamental change in organization structure with a significant impact that serves as a distraction to environment stability. Friedman and Singh (1989) identified two types of disruption a CEO turnover may cause. First, as a significant change, it can alter the alignment between an organization and its environment. Second, as explained by the bureaucratic theory, it can negatively affect internal structure by interfering with the existing coordination mechanism and work patterns in a company.

Consequently, a CEO turnover will be perceived as a piece of bad news by the stockholders which in turn leads to adverse market reaction.

Hypothesis development

Successors' Origin

Previous studies have documented empirical evidence noted that the majority of the successors of CEO turnovers are company insiders. Promoting internal candidates provide several advantages for an organization. According to the specific human capital accumulation theory, internal candidates may pose some piece of better information on the company-specific procedure, technological advantage, more profound knowledge in products, customers and the market, and better networking with the customer (Dherment-Ferere & Renneboog, 2002). Also, they can exploit their existing network within the company to obtain relevant information. Hence, this specific information superiority poses by the internal candidates, makes them more attractive compared to external candidates.

Furthermore, considering outsiders as successors may have negative implications. Chan (1996), for instance, argues that when an organization considers an external candidate for CEO succession, internal candidates will become less motivated and leads to a decline in his/her current performance. When a new member is considered as a potential successor for the CEO position, the chance for insiders to become CEOs diminishes. Likewise, Hannan and Freeman (1984) argue that the introduction of outsider new members is likely to destabilize the team itself and disrupt more extensive organizational routines and relationships. Hence, investors should interpret the appointment of an insider as a new CEO as a piece of good news. Therefore, the following hypothesis is introduced:

H1: Appointing internal candidates as the new CEO yields positive abnormal returns.

Forced Turnover

The information hypothesis theory states that a forced CEO turnover reveals information about poor management choices (Bonnier & Brunner, 1989) or managerial quality that is worse than anticipated (Warner, Watts, & Wruck, 1988). This hypothesis predicts that the market value of the stock will react negatively to the announcement of a forced turnover. As a forced CEO, turnover information is released, private information is revealed to the external party. Consequently, the investor negatively reacts to new information about poor management choices (Bonnier & Brunner, 1989).

Negative returns could also occur if a forced CEO turnover is perceived as a loss of valuable human capital previously poses by the company (Dherment-Ferere & Renneboog, 2002).

According to resource-based view theory, top management such as CEO with a certain level of experience is a valuable human capital for the company. A CEO dismissal might be perceived as the loss of the company's human capital by the investor, which in turn leads to an adverse market reaction.

Drawing from the information hypothesis theory, we argue that the market will give a negative reaction once there is information about a forced CEO turnover. Consequently, the following hypothesis was introduced.

H2: Forced CEO turnover announcement yields negative abnormal returns.

METHODS

Data

The data of CEO turnover announcements was compiled from various sources by employing hand-collected data collection. The primary source was the corporate disclosure in the Philippine Stock Exchange (PSE). The PSE website only provides data for the past two years. To obtain the complete list of CEO announcements from January 2008 to December 2018, the following sources were screened: (i) daily news in Philippines online business newspapers (e.g., Business Mirror and Business World) (ii) company-specific news provided by Bloomberg and Reuters, (iii) companies' web sites, and (iv) selected leading online news site (e.g., ABS-CBN News, Inquirer, Manila Bulletin, Manila Standard, Manila Time, The Philippine Star, and Rappler). This procedure yielded a sample of 245 initial observations.

The announcements news also typically provides a brief description of the turnover characteristics and successors' background. This information was used to collect data regarding the type of CEO turnover, origin, and gender of the successor. Observations with confounding events during the five-day event windows before and after the turnover announcement were removed from the sample. The confounding events details were collected from the same source of data. The event included earning and or dividend announcements, mergers, acquisition, expansion, and new product launches. Stock-return and market return data were obtained from the DataStream database. Figure 1 shows the distribution of the daily stock and market return across the observation period.

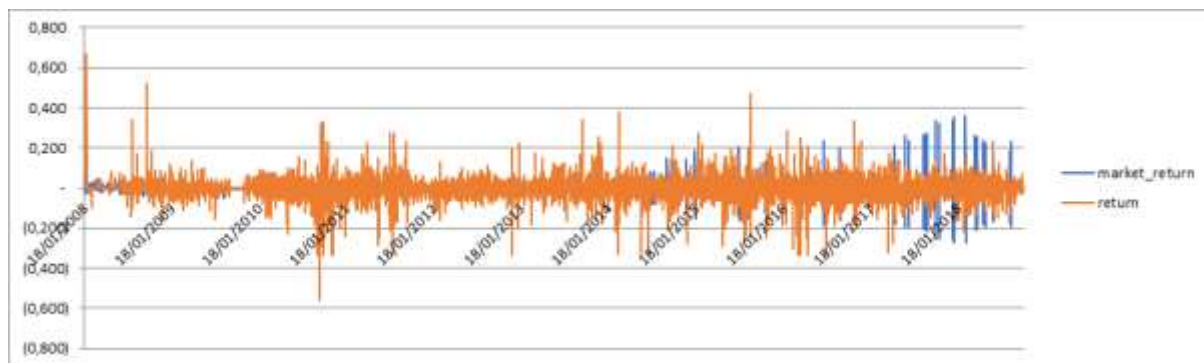


Figure 1. Individual Daily Stock and Market Return Across Observation Period

There are several sample criteria used in this study. First, the date of the CEO turnover announcement must be identifiable. Second, the background information of the event must be known (turnover type, successor origin, and CEO’s gender). Third, there should be no confounding events within the event windows around the announcement date of the CEO turnover. Additionally, the company must be listed in the stock market at least 120 days before the turnover announcement date to ensure the accuracy of the market model analysis. Hence, this results in a final sample of 136 observations. The detailed number of samples in this study is presented in Table 1.

Table 1. CEO Turnover of Philippines Public Firms From 2008 to 2018

Year	Type of turnover				Male	Female
	External	Internal	Forced	Voluntary		
2008	0	2	0	2	1	1
2009	1	4	0	5	5	0
2010	3	7	1	9	8	2
2011	7	3	2	8	8	2
2012	2	8	2	8	8	2
2013	6	7	2	11	12	1
2014	7	8	1	14	14	1
2015	6	17	5	18	20	3
2016	5	9	5	9	10	4
2017	8	10	8	10	16	2
2018	8	8	7	9	15	1
Total	53	83	33	103	117	19

Variables

The main independent variables in this study were the origin of the incoming CEO (external vs. internal), the type of the turnover (forced vs. voluntary), and the gender of the successor (male vs. female). Following the previous studies (Reinganum, 1985; Boeker, 1997; Warner, Watts & Wruck, 1988; Furtado & Rozeff, 1987; Khurana & Nohria, 2000), the succession is classified as external if the incoming CEO is hired from a different company. All other successions are classified as internal.

This study employs several rules in classifying the turnover type. Following Parrino (1997), succession is classified as forced if the following criteria are satisfied: (i) the departure CEO is reported fired, removed from the position, or resign for no apparent reason; (ii) the source does not indicate the reason for the departure as related to mortality, health, or position appointment; and (iii) the news reports that the reason for turnover is retirement of the departure CEO, but does not indicate the retirement was six months prior to the turnover data. In addition, as noted by Kang and Shivdasani (1996), the turnover is considered to be forced if the departure CEO does not hold the position in the board of directors. All other cases are classified as voluntary turnover.

Table 1 displays the number of external and internal, forced and voluntary turnover and successor gender. There is a total of 136 CEO turnovers from January 2008 to December 2018 in the Philippines. Among these, 53 (39%) are external, and 839 (61%) are internal. Concerning the type of turnover, 33 (24%) are forced, and 103 (76%) are voluntary. While with regard to gender, 117 (86%) are male, and 19 (14%) are female.

Analysis

To examine the effect of CEO turnover publication on the change in share prices, a standard market model event study analysis was applied (Fama, 1976, 1984; Brown & Warner, 1985; Peterson, 1989; Campbell et al., 2001). The analysis assumes that the stock market is efficient in which stock prices reflect the information about the CEO turnover. In line with other event studies, the parameters of the market model are estimated over the 100-day estimation window (-120, -20), where day 0 denotes the announcement date.

The estimation of the expected return $E(R_{i,t})$ was performed by the following regression:

$$E(R_{i,t}) = \alpha_i + \beta_i R_{m,t} + \varepsilon_i$$

where $R_{m,t}$ is the return of the reference market on day t and ε_i is the error term.

The abnormal stock returns in the event window ($AR_{i,t}$) was calculated as follows:

$$AR_{i,t} = R_{i,t} - E(R_{i,t})$$

where $R_{i,t}$ is the actual returns of firm i on day t and $E(R_{i,t})$ is the expected returns of firm i on day t .

The average abnormal return during day t $AAR_{i,t}$ was calculated using the following equation:

$$AAR_{i,t} = \frac{1}{N} \sum_{i=1}^N AR_{i,t}$$

where N is the size of the sample.

The cumulative average abnormal returns $CAAR_{(T_1, T_2)}$ were then estimated using the following expression:

$$CAAR_{(T_1, T_2)} = \sum_{t=T_1}^{T_2} AAR_t$$

where T_1 and T_2 are the actual days of the event.

The magnitude of CAAR was measured by examining their statistical significance. The empirical analysis in this study was done by calculating the abnormal returns for each category of turnover: successor origin (external or internal), turnover type (forced or voluntary) and gender (male or female).

As suggested by McWilliams and Siegel, (1997), the ideal event window should capture the effect of the measured event, at the same time, minimize the influence of confounding events. Therefore, three different event windows were used in this study [-2, 2], [-3, 3] and [-5, 5]. Regression analysis was employed to test the CAAR's statistical significance. The advantage of this test compared to the t-test is that it allows the use of robust standard errors (Bollerslev & Wooldridge, 1992).

RESULTS

The results obtained in this study are reported in Tables 2 and 3. Table 2 presents the summary of CAAR statistics across the event window of CEO turnover announcements, while Table 3 reports the significance test for the cumulative average abnormal return for the CEO turnover announcement for two-, three- and five-day windows. The results indicate that external, internal, voluntary turnovers and male successor lead to significant positive abnormal returns for all the event windows [-2, 2], [-3, 3], and [-5, 5], while in the case of forced turnover and female successor, the sample companies earn significantly negative abnormal return.

Table 2. **Summary Statistic Cumulative Average Abnormal Return in the Event Window**

Type of turnover	Market Model CAARs (%)						N
	-2 to 2		-3 to 3		-5 to 5		
	Mean	Median	Mean	Median	Mean	Median	
External	2.05	-0.09	2.36	0.74	0.32	-0.65	53
Internal	0.30	-0.43	0.38	-0.69	1.99	-1.12	83
Forced	-0.71	-0.43	-0.22	-0.24	-0.96	-0.94	33
Voluntary	1.52	-0.40	1.59	-0.61	1.59	-0.75	103
Male	1.28	-0.09	1.62	-0.30	1.29	-0.75	117
Female	-0.86	-1.33	-1.73	-0.99	-0.97	-1.12	19

External and internal successors.

The results related to external and internal successor were both significant and positive at a 1% level for all the event windows observed. For the external successor, the highest abnormal return (+2.05%) was detected in the [-2,2] event window. This evidence is consistent with the findings reported by the previous studies (Huson, Parrino, & Starks, 2001; Dherment-Ferere & Renneboog, 2002; Dahya & McConnell, 2005; Adams & Mansi, 2009). In the case of an internal successor, the event window [-5, 5] yielded the highest abnormal return (+1.99%). This finding supports Hypothesis 1 in this study, which predicts that a positive abnormal return is expected following the appointment of an insider as the new CEO. Therefore, it can be concluded that the market positively views the appointment of an insider candidate.

Forced and voluntary turnover

Interesting results were seen with forced and voluntary turnover. CAAR for both subsamples were significant across all observed event windows in different directions. In the case of forced turnover, the abnormal return was significantly negative at a 1% level across all observed event windows, except for [-3, 3] event window. Significance was detected at the 10% level. In the case of voluntary turnover, a significantly positive abnormal return was detected for all observed event windows. The highest abnormal return (+1.59%) was found in [-3, 3] and [-5, 5] event windows. This evidence reinforces the findings of the previous studies on market reaction to CEO turnover (Warner et al., 1988; Mahajan & Lummer, 1993; Dedman & Lin, 2002; Neumann & Voetmann, 2005) and confirms the Hypothesis 2, noting that forced turnover yields negative abnormal return surrounding announcement date.

Type of turnover	Market Model CAARs			N
	-2 to 2	-3 to 3	-5 to 5	
External	0.0204*** (24.31)	0.0234*** (23.10)	0.0197*** (12.80)	53
Internal	0.00306*** (4.69)	0.00388*** (4.57)	0.00331*** (3.91)	83
Forced	-0.00673*** (-8.03)	-0.00189* (-2.06)	-0.00915*** (-10.04)	33
Voluntary	0.0152*** (24.34)	0.0159*** (19.57)	0.0159*** (15.77)	103
Male	0.0128*** (22.06)	0.0162*** (21.75)	0.0129*** (14.35)	117
Female	-0.00788*** (-8.18)	-0.0163*** (-18.14)	-0.00891*** (-6.40)	19

t-statistics in parentheses

* p<0.05, ** p<0.01, *** p<0.001

Male and female successor

This study revealed that there is a significant and negative effect of the cumulative average abnormal returns surrounding the announcement date of the male CEO. These abnormal returns are respectively, 1.28%, 1.62% and 1.29 %, for the event windows [-2, 2], [-3, 3], and [-5, 5]. In contrast, the result for subsamples female appointed CEO indicates a significantly negative abnormal return on average for all the event windows -0.86%, -1.73% and -0.97%, respectively. It can be concluded that the announcement by the board of directors of a new male CEO is positively viewed by investors, while the negative reaction was found in the case of a new female appointed CEO. This evidence is similar to those reported by the previous studies (Lee & Hayes, 2007 and Coxbill, Sanning, & Shaffer, 2009).

DISCUSSION AND CONCLUSION

This paper examined the stock market reaction around CEO turnover announcements in the Philippines. The sample consisted of 136 CEO turnovers of Philippine publicly listed firms between January 2008 and December 2018. The results provide strong evidence that new CEOs' selected attributes and the turnover's characteristics are primary factors that has an explanatory power on the market reaction to the turnover announcement.

Regarding the successor's origin, results confirmed Hypothesis 1, which is appointing internal candidates as the new CEO yields positive abnormal returns at the 1% significance level. This finding can be further explained by specific human capital accumulation theory. Internal candidates provide an advantage for the organization as they may pose better knowledge on the company-specific procedures, technological knowledge, better information about products, customer and market, and a better network with stakeholders. In addition, they can exploit their existing network within the company to acquire specific information. Hence, the market perceives the appointment of internal candidates as good news.

Result also showed a statistically significant positive effect on cumulative average abnormal stock returns surrounding the announcement date of external CEO succession. The potential explanation is that external appointments provide a benefit for the company in terms of new knowledge and competencies to the management team. Therefore, investors interpret this information as good news.

The event study approach shows that there are significant positive abnormal stock returns on average surrounding the voluntary CEO turnover announcement dates. Therefore, it can be concluded that investors, in general, react positively to voluntary CEO turnover. The potential explanation for this positive reaction is found in the adaptive event view theory. Investors view voluntary CEO turnover as a way by which organizations align resources to adjust to the changing environmental requirements (Friedman & Singh, 1989).

This study also provides evidence that there are significant negative abnormal stock returns on average surrounding the forced CEO turnover announcement dates. Hence, it can be stated that that market reacts negatively to forced CEO turnover. This finding can be explained by the information hypothesis view (Bonnier & Brunner, 1989; Huson et al., 2004), which notes that forced CEO turnover reveals poor management decisions yet to be disclosed to the investor or the market. The presence of information asymmetry between the management (insider) and investor (outsider) decreases when the information about the CEO turnover is released, followed by a negative reaction of the market as the response to the bad news about the poor management decision is made public.

Furthermore, this study provides new evidence into the gender effect of CEO turnover using data from the Philippines publicly listed firms. While a significantly positive abnormal return is found in the appointment of male CEO candidates, the opposite was observed with female CEO successors across all event windows. Therefore, it can be further concluded that the

announcement of the male CEO is perceived as good news by investors as opposed to the selection of female CEOs.

The contributions of this study to the literature are threefold. First, it provides the first empirical evidence of market reaction to CEO turnover from the Philippines emerging market. This study also reinforces the previous findings on CEO turnovers by looking into several categories, namely external, internal, forced, and voluntary. Finally, it enriches the limited empirical evidence on the CEOs' gender effect on abnormal return surrounding turnover announcement date.

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