ANTECEDENTS OF CEO SUCCESSORS ORIGIN: EVIDENCE FROM AN EMERGING ECONOMY

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Abstract

This study investigates the factors affecting a CEO successor's origins in an emerging market. Pre-succession performance, ownership structure, and incumbent CEO change type variables are used as determinants of successor origins choice. We found that when poor firm performance leads to CEO change, the firms are more inclined to appoint outsiders as successors. However, firms prefer more inside successions after a voluntary CEO change. We found that international and local business group companies are using intergroup transfer excessively as a mode of new CEO appointment. These firms are benefiting from various advantages of both outside and inside succession at the same time by appointing group affiliated executives to CEO positions.

Key words: CEO succession, CEO successors' origins, emerging economy

1. Introduction

Several research results show that the turnover rate for top executives is increasing, and that managing top executives (especially chief executive officers [CEO]), the succession process, and selecting a successor are becoming more crucial for firm success and survival (Hutzschenreuter, Kleindienst, & Creger, 2012; Shen & Cannella, 2002, 2003; Zhang & Rajagopalan, 2004, 2010). As CEO succession is a critical event for all types of companies, we have also witnessed an increasing academic interest in this subject over the past few decades. Driven by the work of Grusky (1960; 1961) in the 1960s, top executive succession has become a topic of interest across a variety of scientific disciplines such as strategy, organization, finance, and leadership (Giambatista, Rowe, & Riaz, 2005; Kesner & Sebora, 1994). This study's aim is to focus on antecedents of CEO successors' origins. Prior research has explicitly discussed the theoretical benefits of both inside and outside successions (Zhang & Rajagopalan, 2010). Our main objective is to determine under which circumstances firms prefer an inside successor to an outside rival in an emerging market. CEO succession research is an emerging field in Turkey, and a very limited number of empirical studies have been conducted in this area. CEO succession was examined as a factor in organizational performance, finding an inverse relationship between CEO turnover rate and firm performance (Doğan ve Ağca, 2013; Durukan, Özkan ve Dalkılıç, 2012).

2. Theory and Hypothesis

An impressive number of studies examined the effects of CEO succession as well as various successor characteristics on firm performance (Datta & Rajagopalan, 1998; Karaveli, 2007; Shen & Cannella, 2002; 2003; Virany et al., 1992; Zhang & Rajagopalan, 2004) but their results remained mixed. It is believed that these mixed results are found because the outcomes of CEO succession are dependent on some specific organizational and social context, and the conditions in which they occur (Minichilli et al., 2014). The purpose of this study is to analyze the context and the conditions that influence the choice of the successor's origins. We aim to contribute to the literature on leadership succession by examining the antecedents of successors' origins in a different social context (Chung & Luo, 2013). Many researchers accentuate the impact of social context on CEO succession and suggest that the alignment between the reasons for CEO replacement, social context, and successor origins are essential in order to achieve positive performance consequences after a leadership change (Chung & Luo, 2013; Day & Lord, 1988; Giambatista, Rowe, & Riaz, 2005; Kesner & Sebora, 1994). However, most of the studies in this area are conducted in the developed country context, and developing country experiences remain limited (Claessens & Djankov, 1999; Kato & Long, 2000; Peng, Buck, & Filatotchev, 2003). We think that this descriptive study conducted in an emerging market, namely Turkey, will contribute to the field by analyzing the antecedent of successor origins and comparing inside succession with outside succession in a different social context that brings together organizations working with different institutional logics such as families, business groups, and international companies.

The origin of a CEO successor has important organizational implications, and one of the important motivations for our study was to understand the circumstances under which a firm chooses a new CEO with a different origin. There are options for selecting a CEO successor including selection of an insider among internal candidates and a comprehensive search of external candidates. Extant literature provides valuable insights into the antecedents of inside (intrafirm) versus outside-firm CEO succession (Finkelstein & Hambrick, 1996; Kesner & Sebora, 1994). However, when CEOs are chosen from the outside, some come from within the hiring firms' industries, whereas others are chosen from outside their industries. Very little is known about the antecedents of these choices, because typically the majority of the prior research has not distinguished between intra-industry and outside-industry successors (Datta & Rajagopalan, 1998; Jalal & Prezas, 2012). In general, promotion from within is most commonly used in the succession method to fill the vacated CEO position (Ocasio, 1999). Insider successors have more company-specific and industry-specific knowledge, will have a better understanding of the company's strategic requirements and relationship networks, and the company's board will recognize the candidate and will have relevant information about the competence and prior performance of that candidate (Harris & Helfat, 1997; Zajac, 1990). It is assumed that insiders will have shorter learning curves, will adapt quickly to new tasks, and boards of directors of the company may trust the insider managers more easily (Cannella & Shen, 2001). Furthermore, promotion from within will have advantages, for example insider successor cost will be relatively lower compared to that for the outsider candidates. It is expected that morale, motivation, and commitment within the company will be strengthened with internal promotions, and the company's capacity to attract and retain qualified executives will be enhanced (Friedman & Saul, 1991). Of these, the selection and crowning of an heir apparent or internal candidate is the most formal and traditional succession process. However, research shows that the origin of the CEO successor is dependent on several factors (Pitcher, Chreim, & Kisfalv, 2000; Zhang & Rajagopalan, 2003). Some of these factors are firm performance, firm growth level, scale, age, or the company's current level of compliance with the standards in the industry (Kesner & Seborra, 1994). The most obvious potential predictor of whether a new CEO will come from the outside is the performance of the organization in the period before succession. Of the several studies examining this issue, they found that good firm performance tends to lead to an insider successor, while poor firm performance tends to discourage it (Boeker & Goodstein, 1993; Cannella & Lubatkin, 1993; Zhang & Rajagopalan, 2004).

H1: Pre-succession firm performance will be positively related to the likelihood of insider succession.

However, studies on the impact of firm pre-succession performance on CEO succession have also investigated the link between the type of CEO successor and the reason for CEO succession. For example, some researchers (Puffer & Weintrop, 1995) argue that neither corporate performance nor the composition of the board explains successor origin when that succession is caused by the voluntary retirement of the incumbent CEO. Nevertheless, they conclude that when the incumbent CEO is forced to leave, past performance is likely to be the key determinant of the choice of his or her successor. In this perspective, we propose the following:

H2: The probability of appointment of an insider successor is higher when the succession is caused by voluntary reasons.

Many other organizational characteristics also affect top executive succession. Some of these characteristics are used and analyzed as variables in studies. However, variables related to ownership structure of the companies have been scantly studied. In particular, family ownership, foreign ownership, and business group structure are among those organizational characteristics (Finkelstein, Hambrick, & Cannella, 2009). Emerging economies are gathering together companies functioning with different institutional logics, and are providing researchers with a more heterogeneous social context and relationships. This is why they provide researchers a more interesting setting to investigate the characteristics of CEO successors (Dacin, Ventresca, & Beal, 1999; Thornton & Ocasio, 2008). Chung and Luo (2013) propose that in developing countries where market dynamics are weak, transaction costs are high and information asymmetry is acute. Outsider CEO successors have powerful connections and legitimacy conferred by stakeholders, which plays a crucial role in helping firms access resources and lower transaction costs, bringing fresh knowledge and managerial perspectives and thus facilitating firm performance. Successors appointed from outside the company are also considered to enhance the firm's capital, as they are selected from a larger pool of candidates (Bennedsen et al., 2007; Chung & Luo, 2013).

Several studies also reveal that family ownership, especially in developing countries, is an important factor affecting the company's management structure and performance (Carney, 2005; Chrisman, Chua, & Zahra, 2003; Çolpan, 2010; Habbershon & Williams, 1999, Habbershon et al. 2003). Finkelstein, Hambrick, and Cannella (2009) suggest that family ownership is not only an issue to consider for developing countries, but research conducted in the US on the impact of family control has found that it is underestimated. Our sample also provides us a rich opportunity for studying family business groups. Several studies reveal that in Turkey, the family business group is a dominant form of business organizing, and in particular the business group (holding) affiliated companies are directly or indirectly owned by family members (Buğra, 1994; Gökşen & Üsdiken, 2001; Kula, 2005; Demirağ & Serter, 2003; Yamak & Üsdiken, 2006; Yurtoğlu, 2003). In our sample as in the other developing countries where family business groups (Guillen, 2000; Khanna & Palepu, 2000; Khanna ve Yafeh, 2007) and international companies are the dominant structural form, we assume that there is a high probability that outsiders and CEO successors are coming from (local or foreign) group affiliated companies.

H3: The probability of the appointment of outsider successors coming from (local or foreign) group-affiliated companies is higher in family business groups.

3. Methods

3.1. Context, sample, and data sources

We test the above hypotheses in the context of Turkey for the years 2010 and 2011. Our sample comprises all publicly-listed firms on the Istanbul Stock Exchange (TSE). In total, there are 523 firm-year observations pertaining to 258 different firms. Our research design includes firms that experienced CEO succession and those that did not. It also includes, for firms experiencing leadership succession, information on both succession and non-succession years. Giambatista et al. (2005) point out that in succession research, many studies examine only succession events but do not address how different types of successors compare with non-succession in their performance impact.

We collected information on annual firm performance and other firm characteristics from the *KAP* (Public Disclosure Platform of Turkey) electronic database, the most comprehensive database for listed companies in Turkey, and from individual companies' financial reports. For CEO succession and the origin of successors, we adopted a multisource strategy to search all relevant information for succession cases. We first identified CEO (or general manager) changes from the list of names provided by the *KAP* database. There were 81 cases of succession during our observation period. Of these changes, 40 occurred in 2010 whereas 41 took place in 2011. In 6 cases, more than two managerial changes occurred during the analyzed years. We then searched various databases and firms' financial reports and other documents to locate background information on both the incumbent CEO and the origin of the successor CEO.

Pre-succession performance: We used return on assets (ROA) as the independent variable for firm performance because ROA is a well-understood and widely used accounting measure of operational performance (Shen & Cannella, 2002; Zajac, 1990). We did not use market valuation, which is often subject to forces beyond management's control, since our study attempts to understand the impact of succession on a firm's performance.

CEO succession reason: The reasons for CEO succession are classified in this variable. The reasons for the changes were primarily identified with the help of the firms' public disclosures and financial press news. Planned retirement and voluntary departure of the incumbent CEO are coded as "natural departure," whereas the refusal to renew the contract by the employer, replacement of the incumbent CEO following a "policy disagreement" or "difference in opinion or some equivalent reason" are classified as dismissals (forced departures). We also differentiated cases where the CEOs were appointed to a new position within the firm or were affiliated with business groups and thus needed to be replaced by a successor.

Ownership Structure: We controlled for ownership and governance through the percentage of shares owned by the controlling family, foreign institutional companies/investors, and business group ownership. The term, "controlling family" refers to the family with the largest shareholdings in a firm's ownership structure. Family members own company shares either directly or through other public and private firms that are de facto under their control. We consider the pyramid structure in ownership to calculate family shareholding by using the methodology developed by La Porta et al. (1999).

Successor origins: The origin of a new CEO was classified into two basic categories: inside and outside firm successor. Consistent with recent succession studies, inside succession was defined as one in which an executive with firm tenure of at least two years had been promoted to the CEO position (Cannella & Lubatkin, 1993; Harris & Helfat, 1997; Ocasio, 1999; Zhang & Rajagopalan, 2003). Outside firm succession was classified first into two main categories: business group affiliated and non-business group affiliated outsiders. Next, we checked whether the outsiders are examples of intra-industry and outside-industry succession. Intra-industry succession was defined as one in which the successor CEO had firm tenure of less than two years but had industry tenure of at least two years in the same industry in which the hiring firm was categorized. Outside-industry succession referred to succession in which the successor CEO had industry tenure of less than two years in the same industry. In order to classify the industry origin of a new CEO, we followed the procedure described in Harris and Helfat (1997) as proposed by Zhang and Rajagopalan (2003).

***Control variables**:* In view of the prior CEO succession literature, we controlled for industry and firm size. Previous research has shown that CEO succession and CEO successor origins have differing effects depending on an organization's size. Firm size was measured by the logged values of annual firm sales. Industry is a dummy variable that is equal to 1 for the service sector and to 0 otherwise.

4. Data Analysis and Results

Table 1 reports descriptive statistics of our sample and variables. To test our hypotheses, we used logistic regression analyses. We used this methodology to estimate simultaneous logistic regression models with "pairwise" comparisons of firms' pre-succession performance and CEO successors' origins (Parrino, 1997). Our model included CEO successor origin as a dependent variable and pre-succession performance, ownership structure, and CEO change reasons as independent variables. Table 1 presents descriptive statistics. Table 2 and Table 3 present the multinomial logistics estimates for our model.

Our model in Table 2 was statistically significant (chi-square = 53.081; $p < 0.05$). From the results of the multinomial logistic regression analysis shown in this table, we found that insider successor choice of the companies is affected by pre-succession performance and voluntary departures. As hypothesized, we found that firms are more tented to replace the incumbent CEO with an insider when the firms performed well financially. We observe that the reason and type of CEO change affects the choice of an insider successor. When the incumbent CEO leaves the company voluntarily, the probability of appointing an insider replacement increases. However, companies' choices of outsiders are strongly and inversely related by their size and industry, and are positively related to pre-succession performance and planned type of voluntary CEO change. As proposed in our hypothesis, we found that in family business groups, the probability of appointment of outsider successors from group-affiliated companies is higher.

5. Conclusion

A number of studies have been conducted on antecedent CEO succession and choice of successor. We believe that CEO succession decisions and events depend on the specific organizational and country context in which they occur; thus, there is still a need to conduct analysis in different research settings.

This paper analyses the determinants of choice of CEO successor in Turkey. The three hypothesized determinants of successor choice are pre-succession performance, ownership structure, and incumbent CEO change type. The main contribution of our paper is to bring new insight from an emerging market to the investigated variables. We found that when poor firm performance leads to CEO change, the firms are more inclined to appoint outsiders as successors. However, firms prefer more inside successions after a voluntary CEO change. These results are consistent with our theoretical arguments and previous research findings. It is also worth to note that 53 percent of the firms favor outside successors to replace recurrent CEOs. One of the important contributions of this paper thus is to analyze in depth the characteristics of these outside CEO successors. In this respect, outsiders are classified into three subgroups: inter group companies' transfer, intra industry transfers and different industry transfer. We found that international and local business group companies are using intergroup transfer excessively as a mode of new CEO appointment. We found that 44 percent of the outsider CEOs are coming from group affiliated companies. This intergroup top executive transfer can be classified as a related outside succession. We know that family owned and managed business groups and international companies are very common organizational forms in Turkey. We can say that firms are benefiting from various advantages of both outside and inside succession at the same time by appointing group affiliated executives to CEO positions.

In conclusion, we would like to acknowledge some limitations of our study. First, like most research on CEO succession, our study relied on archival data rather than on direct observations of succession. Second, this study classified successors based only on their origins. A finer-grained classification of outside would provide further explanation of the choice of a successor. Some background characteristics of CEOs, such as previous experience, age, education and tenures, could contribute to an understanding of succession events. Finally, we used a limited sample of large and listed firms. This sample and sample size may limit the generalizability of our findings to other contexts, in particular, to the emerging market context. Future research needs to replicate and extend our model in other organizational contexts with a larger sample size.

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Table 1. Descriptive Statistics

	Mean (percent/standard deviation)
CEO succession	77 (14.8%)
CEO change reason	
- Voluntary departure	31 (40.3%)
- Retirement	15 (19.5%)

- Dismissal - Other assignment - Organizational restructuring	1 (1.3%) 28 (36.4%) 2 (2.6%)
CEO successors' origin - Insiders - Outsiders - Intragroup - Outsiders - Intra-industry - Outsiders - Different Industry	36 (46.8%) 18 (23.4%) 12 (15.6%) 11 (14.3%)
ROA	0.03191 (.1806)
Size (log of total sales)	18.1938 (2.31799)
Sector (dummy for service)	0.4203 (0.49409)
Ownership structure - Business groups shares - Family shares - Family business group shares - Foreign companies' shares	57.31 (23.089) 63.50 (22.15) 40.25 (28.56) 12.53 (26.75)

Table 2. Results of the Multinomial Logistic Regression: Determinants of Choice of Successors' Origins*

Successors origins [a]		**B**	**S.E.**	**Wald**	**df**	**P(sig)**
1-Insiders	Pre-succession performance	10.186	5.854	3.027	1	.082
	Voluntary change	17.511	3567.91	.000	1	.043
2-Outsider-inter group company transfer	Size	.291	.300	.940	1	.032
	Industry	-1.588	1.424	1.244	1	.035
	Retirement	17.377	1.656	110.06	1	.000
	Ownership (FBG)	.021	.030	.490	1	.048
3-Outsider-intra-industry	Pre-succession performance	6.525	5.163	1.597	1	.020
	Size	-.528	.419	1.587	1	.020
N = 521						
Model chi-square = 53.081; $p < 0.05$, –2 log likelihood = 147.247, P Pseudo R2 (Nagelkerke) = .651.						

***Final model included only significant variables at the .10 level)**

[a] The reference category is 4 (succession by an outsider from a different industry)