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Barrons Best CEOs: How Did their Firms Fare?

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Barrons Best CEOs: How Did their Firms Fare?

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Abstract - The Barron's World's Best CEO list has been published each year since 2005. While there are numerous studies concerning the post-announcement share price reaction to firms included on the list, this is a definitive study that looks at the issue of CEO replacement following the announcement of the CEO to the list. This study determines that firms that do not change CEOs perform better; firms with CEOs with shorter tenures have lower returns than those with CEOs with a longer tenure; the reason for the replacement matters in terms of future performance with negative reasons such as performance and mergers yielding lower returns; inside successors produce higher returns than outside successors; and CEOs who appear on the list five or more times show significantly higher results.

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I. Introduction

The Barron's World's Best CEO list has been published each year since 2005. While there are numerous studies concerning the post-announcement share price reaction to firms included on the list, this is a definitive study that looks at the issue of CEO replacement following the announcement of the CEO to the list. This study determines that firms that do not change CEOs perform better; firms with CEOs with shorter tenures have lower returns than those with CEOs with a longer tenure; the reason for the replacement matters in terms of future performance with negative reasons such as performance and mergers yielding lower returns; inside successors produce higher returns than outside successors; and CEOs who appear on the list five or more times show significantly higher results. This is an extension of the Filbeck et al (2012) study.

II. Statement of the Problem

While the event analysis is important and interesting, the question answered by the Filbeck et al study (2012) only considers the announcement effect. However, from a management perspective, we are interested in what happens next. How do the firms perform after the announcement? Do the CEOs stay in place? Is there a difference between those firms in which the CEO stays on or not? What if the CEO is replaced within a short period, is there a difference in the performance vs. a longer term CEO replacement? Does the reason for replacement matter? Does the firm perform better or worse if the new leader is an internal candidate? If a CEO is frequently on the Barron's Best CEO list, does the firm perform better?

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III. Research Questions

a) Leadership and Leadership Change

Meindl and Ehrlich in their seminal work on leadership claimed that the concept had taken on a "larger than life" quality (1987, p. 91). They identified, as early as 1987 that an annual rate of 250 scholarly articles appeared annually from 1972-1983. Additionally, they reported that Fortune highlighted the U.S. Business Hall of Fame while Forbes and other publications also created lists of excellence. Meindl et al (1985) discussed the Romance of Leadership as a strong belief or faith in the notion of leadership and its influence on the function or dysfunction of an organization.

If a leader being named to the Barron's List is an indicator of a high performing firm, then we might assume that if the firm changes their CEO, that the firm would experience lower performance.

H1. Companies that replace the CEO following appointment to the Barron's List, experience lower returns.

b) CEO Tenure

CEOs with shorter career horizons, as indicated by age, will tend to be more risk averse. This, in turn, will negatively affect firm performance (McClelland, Barker, & Oh, 2012). In a study by Brauer, he discusses the effects of short and long-term management behavior on financial performance (2013). One issue in his study is that CEOs may have different objectives depending on whether they may be in the job for a long or short period. He notes decreasing CEO tenure does not give incentives to the CEO to perform in a manner that is good for the firm. We may conclude that the longer the firm operates with a "good" CEO, the more the benefits accrue to the firm since they should be operating with a longer term perspective.

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H2. Companies that replace the CEO within a short period following appointment to the Barron's List experience lower returns.

c) CEO Replacement Rationale

The critical role of a CEO in innovation performance is confirmed even if the firm experiences the sudden death of that CEO (Bearskin & Hsu, 2013). CEO turnover, when it is a result of an unplanned event, will not necessarily be perceived as negative (Koch & Fenili, 2013). Even tragic circumstances may result in a positive effect and impressions by investors.

CEO compensation is one measure of success. CEOs that have more international diversification, higher accounting earnings performance, and larger firm size among other criteria are considered successful (Wang, Venezia, & Lou, 2013). One would presume that if a CEO was successful in those terms that they would not be replaced. Further, the success should continue. However, if the CEO is replaced due to poor performance, then it is likely the poor performance will continue.

H3 Companies that replace the CEO for perceived negative reasons experience lower returns than those who were replaced for non-negative reasons.

d) Internal vs. External Successors

Mobbs and Raheja conducted a study that compares firms that use successor-incentive (single executive) and tournament-incentive among inside managers (2012). Successor-incentives are more likely in firms where human capital is more important and where external CEO replacement is limited. These firms have lower CEO turnover sensitivity due to firm performance.

In another study, Bereskin and Hsu (2013) determined that new internal successors have more innovation than new external CEOs. They also found that innovation quantity and quality are positively associated with option compensation. Finally, innovation performance was identified as a critical role of CEOs. Therefore, we hypothesize that:

H4 Companies that replace the CEO who was named to the Barron's List with an internal successor will experience higher returns than those who replace the CEO with an external successor.

e) Repeated Recognition

Barron's author, Andrew Bary, in a cover article for the magazine stated that there was a higher bar for keeping people on the list (Barry, 2013). Thus, the more times a CEO appears on the list, the more likely it is that the firm will have higher performance.

H5 If a CEO is named to the Barron's List multiple times, the firm will experience higher returns than those firms who are CEOs were named fewer times.

IV. Sample and Methodology

a) Sample

We use Barron's annual "World's Best CEOs" listing as the basis for this study. Barron's annual "World's Best CEOs" was first published in the March 27, 2005 issue. Barron's made the selection of the top 30 leaders based on a number of criteria including earnings growth, stock performance, leadership strength and industry stature, competitive challenges faced in their respective businesses, and job tenure of at least three years. The criteria for the Barron's list like many others are subjective. Barron's notes that the criteria used exhibit a bias toward firms with good earnings growth and stock market performance toward long-standing CEOs. The initial survey featured 22 US-based and 8 foreign firms, with the subsequent surveys in 2006 and 2007 containing 20 US-based and 10 foreign firms (Filbeck et al., 2012).

b) Data Collection and Analysis

To test how these best CEOs perform after being listed in Barron's list and whether the performance after the announcement leads to future CEO replacement, we search the news from Lexis/Nexis on these CEOs until the end of 2012. If the CEO was replaced before the end of 2012, we also search the reason for the replacement (illness/death, poor performance, voluntary resignation, merger/acquisition), and whether the successor is from inside or outside the company. Then, for each stock in our Barron's list, we calculate the average monthly returns for the stock starting from the announcement month of Barron's list until the month the CEO was replaced. If the CEO remains in place until the end of 2012, we calculate the average monthly returns for the stock starting until the end of 2012.

There were 146 different firms in the Barron's list from 2005 – 2012. Of these, 78 (53%) changed their CEO during the post-announcement period until 2012. We were not able to discern the reason for the change and whether the successor was internal or external in five of those CEO changes. The sample is described in Table 1.

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Table 1 : Sample Description

	Number of Firms	%
Total Sample	146	100
Change in CEO	78	53
No Change in CEO	68	47
# of years until CEO Change		
<1	7	9.0
1	16	20.5
2	20	25.6
3	17	21.8
4	8	10.3
5	4	5.1
6	3	3.8
7	3	3.8
Change in CEO Rationale		
Illness/death	6	8.2
Voluntary resignation	30	41.1
Poor Performance	30	41.1
Merger/acquisition	7	9.6
Internal vs. External Successor		
Internal	53	72.6
External	20	27.4
# Years on Barron's List		
1	23	15.8
2	31	21.2
3	31	21.2
4	32	21.9
5	5	3.4
6	24	16.4

We performed a t-test using the average monthly returns from announcement date for each of the categories in Table 2. The level of statistical significance of the difference between the announcement date and the occurrence noted in the leftmost column and the direction is shown in the column entitled t-stat. The average monthly returns are shown in the middle column.

We also calculated several regression models to support or disprove our hypotheses. These are shown in Table 3.

Table 2 : Results for Announcement to Change or End of Period

	Number of firms	Average monthly returns (%)	t-stat
H1. Change of CEOs vs. No change of CEOs			
Change of CEOs	78	0.369	1.22
No change of CEOs	68	0.890	9.04***
H2. Number of years until change of CEOs			
< 1 year	7	1.525	1.54
1 year	16	-0.244	-0.24
2 years	20	-0.081	-0.13
3 years	17	0.238	0.56
4 years	8	0.861	1.49

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5 years	4	1.507	1.98
6 years	3	1.673	1.89
7 years	3	0.562	1.93
H3. Different reasons for change of CEOs			
Illness/death	6	3.737	12.10***
Poor performance	30	0.136	0.27
Voluntary resignation	30	0.641	3.14***
Merger/acquisition	7	-2.639	-1.40
H4. Inside or outside successor			
Inside successor	53	1.240	4.62***
Outside successor	20	-1.922	-2.61**
H5. Number of years listed in Barron's list			
1 year	23	0.750	1.99*
2 years	31	0.874	5.89***
3 years	31	-1.201	-2.25**
4 years	32	0.802	5.09***
5 years	5	3.236	4.12***
6 years	24	1.682	6.12***

***, **, * indicate statistical significance at 0.01, 0.05 and 0.10 level, respectively.

Table 2 reports post -announcement CEO changes and average monthly returns. We calculate the monthly returns starting from the announcement month of Barron's list until the month the CEO is replaced (or until the end of 2012 if there is no change of CEO).

V. Results and Discussion

Each of the hypotheses are restated and discussed in this section.

a) Leadership and Leadership Change

H1. Companies that replace the CEO following appointment to the Barron's List, experience lower returns.

As shown in Table 2, firms that experienced a change of CEO had average monthly returns of 0.369% while those that had no change of CEO had average monthly returns of 0.890%. If a leader being named to the Barron's List is a measure of a high performing firm, then a leader who is not on the list would be in a firm with lower performance. The t-stat of the firms with a change of CEO is 1.22 which is not statistically different from announcement to change. Also firms that had no CEO change from the initial announcement to end of the study had statistically higher returns (t=9.04***).

We could assume that once a CEO is announced to the list, that s/he is doing a good job. If performance is good enough to be placed on the list, we would then presume that they would not be replaced by a new CEO.

Therefore, H1 is supported.

b) CEO Tenure

H2. Companies that replace the CEO within a short period following appointment to the Barron's List experience lower returns.

Table 2 shows that in general companies with CEOs replaced within 2 years have lower average returns compared with companies with CEOs replaced after more than 4 years. We may presume that the longer the firm operates with a "good" CEO, the more the benefits accrue to the firm.

Therefore, H2 is supported. Companies who replace CEOs within 2 years have lower returns than those who replaced CEOs after more than 4 years.

c) CEO Replacement Rationale

H3 Companies that replace the CEO for perceived negative reasons experience lower returns than those who were replaced for non-negative reasons.

Given the sample size for various reasons for replacement, by inspection, we grouped illness/death with voluntary resignations and then poor performance with merger/acquisition. The rationale is that firms often will engage in mergers or acquisitions due to less than ideal financial performance or inadequate strategic alignment. Firms whose CEO either resigns voluntarily or due to illness or death are more likely to be performing better. Table 2 shows that if a company replaces its CEO due to performance or merger-/acquisitions, on average, the company will experience lower monthly returns (0.14% and -2.64%, respectively). Further, Table 3 illustrates the regression models developed for these hypotheses. Acquisition ($p<.01$) and performance ($p<.001$) both have negative and significant coefficients which means that these reasons for CEO change lead to lower performance.

Therefore, H3 is supported. Companies who replace the CEO for poor performance or merger and acquisition, both of which may be perceived as negative

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reasons, experience lower returns than firms whose CEO is replaced for non-negative reasons.

d) Internal vs. External Successors

H4 Companies that replace the CEO who was named to the Barron's List with an internal successor will experience higher returns than those who replace the CEO with an external successor.

As shown in Table 3, replacement with an inside successor (Model I) has a significant ($p<.001$) and positive coefficient of 0.986. The firms with an internal successor thus have higher returns than those with an external successor.

Therefore, H4 is supported. Companies with CEOs replaced by internal successors produce statistically higher returns than those companies with CEOs replaced by external successors.

e) Repeated Recognition

H5 If a CEO is named to the Barron's List multiple times; the firm will experience higher returns.

According to Barron's, the requirements for remaining on the list are much higher than the requirements for initial recognition. Table 3 shows that the number of times that a CEO is listed is a significant and positive contributor to firm performance. ($\beta=.249$; $p<.05$) Table 2 also shows that the number of years significantly impacts the monthly returns and the direction and magnitude changes at the five-year mark.

Therefore, H5 is supported. Firms whose CEOs appear on the list more than five times experience higher returns.

Table 3 : Post-Announcement Regression

	Model I	Model II	Model III	Model IV	Model V	Model VI
Intercept	0.254	1.014	0.850	0.850	-0.197	0.550
	(1.23)	(6.41***)	(4.09***)	(4.02***)	(-0.53)	(1.47)
Inside successor	0.986		0.390			2.520
	(2.88***)		(1.22)			(4.40***)
Outside successor		-2.936	-2.772			
		(-6.87***)	(-6.19***)			
Death/Illness				2.887		0.130
				(3.76***)		(0.14)
Performance				-0.714		-2.260
				(-1.82*)		(-4.33***)
Resignation				-0.208		-2.514
				(-0.53)		(-3.84***)
Acquisition				-3.489		-3.509
				(-4.88***)		(-5.23***)
Nlistings					0.249	0.090
					(2.42**)	(0.95)

***, **, * indicate statistical significance at 0.01, 0.05 and 0.10 level, respectively.

Table 3 reports the regression results of post-announcement average monthly returns on CEO changes. We calculate the monthly returns as the average monthly returns starting from the announcement month of Barron's list until the month the CEO is replaced (or until the end of 2012 if there is no change of CEO). Inside successor (outside successor) is a dummy variable which is equal to 1 if the company's successor is from inside (outside) the company when it replaces its CEO, and equal to 0 otherwise; Death/Illness, Performance, Resignation, Acquisition are all dummy variables which are equal to 1 if the company replaces its CEO because of death/illness, poor performance, voluntary resignation, and merger/acquisitions reason, respectively. Nlistings is number of years this company is in Barron's list before the end of 2012.

VI. Conclusion

Since 2005, Barron's has published its "World's Best CEOs" list. This study is the first to investigate the impact of CEO replacement following inclusion on the list. This study determines that firms produce higher returns if a selected CEO remains in place. In addition, higher returns are experienced with CEOs who have longer tenures than those with shorter tenures. Differential responses exist based on the announced rationale for the CEO replacement as those firms offering performance-based reasons or reasons associated with mergers/acquisitions experience lower returns. Those firms who promote a CEO based on inside succession outperform firms that select an outside successor. Finally, longevity matters as CEOs who appear on the list five or more times show significantly higher results than those firms whose CEOs do not attain that status.

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