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# Stock Market Reaction to CEO Turnover after the 2008 Financial Crisis: Evidence from the Philippines and Indonesia

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**Abstract**

This study investigated the market reaction to announcements of CEO turnovers in the Philippines and Indonesia between January 2009 and December 2018. Turnovers were classified with respect to successors' origin (internal versus external), turnover type (forced versus voluntary), and successors' gender (male versus female). Applying market model event study methodology to the hand-collected sample of 340 CEO turnover announcements showed that 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, with regard to the gender difference, the result showed that market reaction was significantly negative for female CEO appointments and significantly positive for male CEOs.

**Keywords:** CEO Turnover, market reaction, abnormal return, market model

## 1. INTRODUCTION

Enormous attention of literature has been given to the chief executive officer (CEO) as the key strategic decision-maker in every organization. The role of CEOs is critical as the decisions they make reflect the entire organization (Hambrick & Mason, 1984). Given the scope and importance of the role and responsibility, a CEO turnover represents a major event in an organization's history and has a specific impact on the company and its stakeholders. This paper investigates the reaction of the Philippines and Indonesia stock market to announcements of CEO turnovers of a listed firm from 2009 to 2018.

CEO turnover is one of the most important corporate decisions (Huson, Parrino, & Starks, 2001; Chen, Cheng, & Dai, 2013). This crucial event 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), alters the existing power structures (Boeker, 1997), influences the direction of the organization through redesigning the administrative framework (Miller, Droge, & Toulouse, 1988); and apply a strategic conduct to better align the organizational behavior of the firm with the environmental dynamics (Pfeffer & Salancik, 2003; Hillman et al., 2009). Furthermore, this change affects not only the internal organization but also the organization's economic and political climate (Brady & Helmich, 1984). This study looks into 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 making a correction of the poor performance of the firm (Zhang & Wiersema, 2009; Voussem et al., 2013).

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This study classifies turnovers with respect to the departure type of the CEO (voluntary or forced), the successor origin (internal or external), and the successor gender.

The aim of this paper is to empirically assess the information content of CEO turnovers from the stockholders' perspective. The expectation is that the abnormal returns in the surrounding of a CEO turnover announcement date will reflect investors' perceptions about the changes in the value of the company's stock. To investigate the market reaction, standard event study methodology was applied (Fama & French 1993; McWilliams & Siegel 1997; Lyon et al., 1999). The analysis of a sample of 136 CEO turnover announcements indicated that voluntary turnover, external, internal, and male successor yielded significantly positive average abnormal return for the [-2, 2], [-3, 3], and [-5, 5] event windows. On the other hand, a significantly negative average abnormal return was detected in the case of forced turnover and female successor.

Previous studies on market reaction to CEO turnover based on developed country data have shown mixed results. Some studies found a significantly positive market reaction (Denis & Denis, 1995, Borokhovich, Parrino, &Trapani, 1996; Kang & Shivdasani, 1995; 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). In addition, some studies found no significant reaction (Reinganum, 1985; Warner, Watts, & Wruck, 1988; Anderson, Jayaraman, & Mandelker, 1992). The present study focusses on the market reaction to CEO turnover in Indonesia and the Philippines. The reason for choosing these two countries because both Indonesia and Philippine is a developing country whose stock market share some characteristics and uniqueness. For instance, unlike other capital markets in developed countries, as an emerging market, the Indonesian and Philippines stock market is often described to have herding behavior (Setyawan, 2013). Herding behavior is a situation where the foreign investor has knowledge capital advantage over the domestic investor, which in turn causes the foreign investor can influence the behavior of the domestic investor. In other words, the investment decision of domestic investors is highly dependent on the behavior of the foreign investor. Hence, it is interesting to test whether the same evidence for stock market reaction to CEO turnover in a developed country would apply in a developing country setting such as Indonesia and the Philippines.

This paper makes a number of contributions to the literature. First, this study provides the first empirical evidence of the market reaction to CEO turnover from the emerging market. Second, this study corroborates the findings of the existing literature on CEO turnovers into several 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.

## 2. THEORETICAL FRAMEWORK

### 2.1 The Efficient Market Hypothesis

The efficient market hypothesis (EMH) states 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 cause a change in the actual price 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 relevant information is known by all market participants. 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 certain time where the price is the actual of security will reflect the intrinsic value of the securities.

In the context of this study, the CEO turnover announcement is potentially causing a market reaction. The reaction will be positive if the market perceived the CEO turnover as good news or negative if the turnover is perceived as bad news.

## 2.2 The Event View of CEO Turnover

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

The inconsequential event view predicts that the announcement of CEO turnover is insignificant and raises no investors' expectations about the firm's prospects. 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 little influence on the company's actual performance (Bommer & Ellstrand, 1996). The inconsequential event view is supported by the scapegoat hypothesis (Gamson & Scotch, 1964) which predicts 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 on other factors 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 will affect investors' expectations about the firm's prospects. This is because the market 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 action taken by the board of directors to signal the external party about their commitment to address and correct the company's poor performance (Voussem et al., 2013; Zhang & Wiersema, 2009).

According to the disruptive event view, any change in an organization leads to a performance decline and greater probability of organizational death (Friedman & Singh, 1989; Hannan & Freeman, 1977). CEO turnover is considered a major change in an organization which increases the likelihood of organizational death. The disruptive event view assumes that the firm's environments are relatively stable over time and that CEO turnover is viewed as a fundamental change in organization structure with a significant impact to trigger a misalignment with the environment. Friedman and Singh (1989) identified two types of disruption a CEO turnover may cause. First, as a major 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 bad news by the investors which in turn leads to negative market reaction.

## 2.3 Hypothesis Development

### 2.3.1 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 company-specific human capital accumulation theory (Dherment-Ferere & Renneboog, 2002), internal candidates may have better company-specific processes, technological knowledge, clearer insights in products, markets and competition, and a closer relationship with clients. In addition, they can exploit their existing network within the company to acquire specific information. Hence, this accumulation of company-specific human capital consequently makes insider candidates more attractive than outsiders.

Furthermore, considering outsiders as successors may have negative implications. Chan (1996), for instance, argues that considering outsiders for the CEO position can reduce the incentives and hence the motivation of lower-level executives. 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 wider organizational routines and relationships. In line with the arguments above, investors should interpret the appointment of an insider as a new CEO by the board as a positive signal. Therefore, the following hypothesis is introduced:

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

#### 2.3.2 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 the stock price will react negatively once the information about a forced turnover is released. As a forced CEO turnover announcement is made, previously private information is revealed to the external party. Consequently, the market negatively reacts to the revelation of poor management choice (Bonnier & Brunner, 1989).

Negative returns could also occur if a forced CEO turnover is associated with a loss of valuable company-specific human capital (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 company-specific human capital by the investor, which in turn leads to a negative market reaction. In line with the information hypothesis theory, the market is expected to react negatively once there is information about a forced CEO turnover, which leads to the formulation of the following hypothesis.

H2: Forced CEO turnover announcement yields negative abnormal returns.

## 3. METHODS

### 3.1 Data

The sample of CEO turnover announcements was obtained from various sources by employing hand-collected data collection. The primary sources were the corporate disclosure in the Philippine Stock Exchange (PSE) and the Indonesia Stock Exchange (IDX) website. In addition, to obtain the complete list of CEO turnover announcements from January 2009 to December 2018, the following sources were screened: (i) daily news online business newspapers (ii) company-specific news provided by Bloomberg and Reuters, and (iii) companies' web sites. This procedure yielded a sample of 363 initial observations from both countries.

The announcements also typically indicate a brief description of the turnover characteristics and successors' backgrounds. This information was used to collect data on the type of turnover, origin, and gender of the new successor. Observations with confounding events during the five-day event windows surrounding the turnover announcement were removed from the sample. The information about confounding events was collected from the same source of data. The confounding event included earning and or dividend announcements, merger, acquisition, expansion, and new product launching. Stock-return and market return data were obtained from the DataStream database.

To be included in the final sample in this study, the following criteria must be satisfied: 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 are no confounding events within the event windows around the turnover announcement date. In addition, the stock must be traded 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 340 observations with clean data. The detailed number of samples is presented in Table 1.

Table 1. CEO turnover of Philippines & Indonesia public firms from 2009 to 2018

| | **Number of CEO turnover** | | |
|---|---|---|---|
| | **Philippines** | **Indonesia** | **Total** |
| Total | 136 | 204 | 340 |
| *Origin* | | | |
| External | 53 | 72 | 125 |
| Internal | 83 | 132 | 215 |
| *Type* | | | |
| Forced | 33 | 37 | 70 |
| Voluntary | 103 | 167 | 270 |
| *Gender* | | | |
| Male | 117 | 193 | 310 |
| Female | 19 | 11 | 30 |

### 3.2 Variables

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

This study uses several rules in classifying turnover as forced or voluntary. Following Parrino (1997), succession is classified as forced if the following criteria are satisfied: (i) the CEO is reported fired, forced from the position, or departs due to unspecified policy differences; (ii) the source does not report the reason for the departure as involving death, poor health, or the acceptance of another position; and (iii) the news reports that the CEO is retiring, but does not announce the retirement at least six months before the turnover. In addition, as noted by Kang and Shivdasani (1996), the turnover is considered to be forced if the CEO does not remain on the board of directors. All other cases are classified as voluntary turnover.

Table 1 shows the number of external and internal, forced and voluntary turnover and successor gender. There is a total of 340 CEO turnovers from January 2009 to December 2018 for both countries. Among these, 125 (37%) are external and 215 (63%) are internal. With regard to the type of turnover, 70 (21%) are forced and 270 (79%) are voluntary. While with regard to gender, 310 (91%) are male and 30 (9%) are female.

To investigate the impact of CEO turnover announcements on stock prices, standard market model event study methodology was applied (Fama, 1976, 1984; Brown & Warner, 1985; Peterson, 1989; Campbell et al., 2001). The test assumes that the market is efficient in which stock prices reflect the information about the CEO turnover announcement. In accordance 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 $\varepsilon_i$ 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 calculated 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 in the event period.

To measure the magnitude of CAAR, it is critical to determine their statistical significance. The empirical analysis in this study starts by measuring abnormal returns for the whole sample and for each category of turnover: successor origin (external or internal), turnover type (forced or voluntary) and gender (male or female).

Following previous studies (Beatty & Zajac, 1987; Warner, Watts, & Wruck, 1987; Weisbach, 1988), several event windows were used in this study. Event window should be long enough to capture the impact of the event, but short enough to minimize the influence of confounding effects unrelated to the event (Brown & Warner, 1985; McWilliams & Siegel, 1997). Therefore, three different event windows were used in this study [-2, 2], [-3, 3] and [-5, 5].

Regression analysis was used to test the CAAR's statistical significance. The p-value on the constant from this regression gave the significance of the cumulative abnormal return across all companies. This test is preferable to a t-test because it allows the use of robust standard errors (Bollerslev & Wooldridge, 1992).

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 | 125 |
| Internal | 0.30 | -0.43 | 0.38 | -0.69 | 1.99 | -1.12 | 215 |
| Forced | -0.71 | -0.43 | -0.22 | -0.24 | -0.96 | -0.94 | 70 |
| Voluntary | 1.52 | -0.40 | 1.59 | -0.61 | 1.59 | -0.75 | 270 |
| Male | 1.28 | -0.09 | 1.62 | -0.30 | 1.29 | -0.75 | 310 |
| Female | -0.86 | -1.33 | -1.73 | -0.99 | -0.97 | -1.12 | 30 |

## 4. RESULTS

The results obtained in this study are reported in Tables 2 and 3. Table 2 presents the summary of CAAR statistics around CEO turnover announcements for a variety of event windows, 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 on average 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.

### 4.1 External and Internal Successor

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 reasonably be concluded that the announcement appointment of an insider candidate is positively viewed by the market.

### 4.2 Male and Female Successor

This study found a statistically significant negative effect of, respectively, 1.28%, 1.62% and 1.29 % on average cumulative abnormal stock returns following the announcement of male CEO 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 Lee and James (2007), Lee and Hayes (2007) and Coxbill, Sanning, and Shaffer (2009).

Table 3. Statistical test cumulative average abnormal return in the event window

| Type of turnover | Market Model CAARs | | | N |
|---|---|---|---|---|
| | -2 to 2 | -3 to 3 | -5 to 5 | |
| External | 0.0204*** | 0.0234*** | 0.0197*** | 125 |
| | (24.31) | (23.10) | (12.80) | |
| Internal | 0.00306*** | 0.00388*** | 0.00331*** | 215 |
| | (4.69) | (4.57) | (3.91) | |
| Forced | -0.00673*** | -0.00189* | -0.00915*** | 70 |
| | (-8.03) | (-2.06) | (-10.04) | |
| Voluntary | 0.0152*** | 0.0159*** | 0.0159*** | 270 |
| | (24.34) | (19.57) | (15.77) | |
| Male | 0.0128*** | 0.0162*** | 0.0129*** | 310 |
| | (22.06) | (21.75) | (14.35) | |
| Female | -0.00788*** | -0.0163*** | -0.00891*** | 30 |
| | (-8.18) | (-18.14) | (-6.40) | |

t-statistics in parentheses
* p<0.05, ** p<0.01, *** p<0.001

## 5. CONCLUSION

This paper examined the stock market reaction around CEO turnover announcements in the Philippines and Indonesia. The sample consisted of 340 CEO turnovers of 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 determinant in explaining the stock-market reaction.

Considering 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 have better company-specific processes, technological knowledge, clearer insights in products, markets and competition, and a closer relationship with clients. 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 abnormal stock returns following the announcement 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.

Event study analysis demonstrates that there are significantly positive abnormal stock returns around the announcement dates of voluntary turnover. Therefore, it can be concluded that the market reacts 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 around the announcement dates of forced turnover. 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 indicates poor management choices yet to be revealed to the public. Asymmetry of information between insiders (the board of directors) and outsiders (investors) diminishes as soon as the CEO turnover is announced, and the market reacts negatively as the revelation of information about the board's poor management choice is made public.

Furthermore, this study offers new evidence into the gender effect of CEO turnover using data from 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. It can reasonably be concluded that the announcement of male CEO appointments is perceived as good news by investors as opposed to the selection of female CEOs.

This paper makes a number of contributions to the literature. First, it provides the first empirical evidence of market reaction to CEO turnover from the two emerging markets Indonesia and the Philippines. Second, this

study corroborates the findings of the existing literature on CEO turnovers into several categories, namely external, internal, forced, and voluntary. Finally, it adds to the scarce empirical evidence on the CEOs' gender effect on abnormal return surrounding turnover announcement date.

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