CEO TURNOVER AND VALUATION OF THE FIRMS

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ABSTRACT

This paper examines stock price reaction to CEO turnover over a one-year period. A sample of U.S. firms was selected that experienced a CEO departure during 2013. The stock price reactions to both the announcement of a CEO departure as well as the CEO departure are analyzed. In addition, a comparative analysis was completed on the different effects on a company's stock price whether the CEO turnover was forced (fired) or voluntary (resignation or stepping down). The findings of this research indicate that following both the announcement and departure of a CEO the company's stock price will appreciate. On average, 60 days following both the announcement and departure dates resulted in the highest percentage increase.

INTRODUCTION

CEO turnover is a significant strategic issue inside corporations and one that must be managed carefully due to the importance a CEO plays inside the organization they lead. The departure of a CEO for any reason also has the potential to affect a company's short and long term profitability as well as investor returns. U.S. CEO turnover has reached its highest level since 2008 with 43 companies in the S&P 500 index working under new CEO's through the third quarter of 2013 (Bloomberg, 2013).

Previous Studies

There have been numerous studies completed on the reaction of a company's stock price in response to CEO turnover as it can have a great impact on the firm's future performance. According to research conducted by Clayton, Hartzell and Rosenburg (2005) CEO turnover increases the company's stock price volatility regardless of whether the departure was forced or voluntary. Stock price volatility refers to the amount of uncertainty or risk about the size of the potential changes in the company's stock value. A higher volatility signals that the stock price could potentially be affected to a greater extent and increase or decrease dramatically over a short period of time. The study also showed that the volatility is higher in the case of a forced turnover as the market reacts more strongly to those departures because they have a greater potential to lead to large strategy changes (Clayton, Hartzell & Rosenburg, 2005). Another research paper by Adams and Mansi (2009) examines the impact of CEO turnover announcements on stockholder wealth and found that CEO turnover events are associated with higher stockholder value. Through their research it was determined that CEO turnover announcements are value creating for stock holders by around 0.6% overall and that stocks observe the largest increases when the turnover is forced by around 2.4% (Adams & Mansi, 2009). This study also stated that higher stock returns associated with CEO turnover is consistent with prior research. Kind and Schlapfer's (2010) study also supported other research and investigated the stock-price results under different turnover situations such as forced or voluntary departure. The study also considered whether the departing CEO was over or underperforming based on their prior relative stock-price performance (Kind & Schlapfer, 2010). This study found that the size of the stock price reaction depended on the characteristics of the turnover event with forced turnovers generating the largest impact on the announcement date (+196.37%). This study also investigated the firm's operating performance and determined that the performance decreases in the years preceding a turnover event but increases were following the event. This on average also reflects the short-term stock-price reaction around the announcement date (Kind & Schlapfer, 2010). Overall these studies agree that the stock price will react positively to a turnover event. These papers have also found that stock price reacts more dramatically to forced turnover events and supports previous research that forced turnovers yield significant positive abnormal returns.

DATA AND METHODOLOGY

Data

A sample of 15 companies was selected that experienced a major CEO turnover in 2013 and are listed on either the New York Stock Exchange (NYSE) or the NASDAQ. The data was collected from various sources including Yahoo Finance, Y Charts, the Wall Street Journal and Bloomberg. With a total number of 1,246 CEO departures in 2013 the sample of 15 companies represents 1.2% of all 2013 turnovers. However, as only 249 of the turnovers occurred in public companies, the sample of 15 is reasonable and represents 6.0% of all public company turnovers. The companies in the sample were selected from a variety of industries to ensure that the results were reflective of market conditions. The selection of companies was also balanced between different reasons for the CEO's departure as close as possible to the distribution of the 2013 turnovers. Of the 15 companies selected 5 CEO's resigned, 4 stepped down, 3 retired and 3 were fired. Although resignation and stepping down have the same meaning, a resignation has a negative connotation as if the CEO is leaving for a negative cause. Stepping down however is seen as a more positive company departure with the possibility of a continuing relationship with the company. All of the selected companies listed have a departure date however, not all companies announced the departure of their CEO therefore those dates could not be included. The stock price of the selected companies was tracked on the announcement and departure dates as well as one week before these dates. In addition, data was collected and tracked for one week, 30 days and 60 days after the announcement and departure dates. The stock prices on these dates were collected from Yahoo Finance and a 60 day window is believed to be sufficient to demonstrate the stock price trends after a CEO turnover.

Methodology

Hypothesis #1: Stock price will increase following CEO departure announcements and CEO departures
It is hypothesized that following both the announcement of the CEO's departure and the actual departure date of the CEO, the stock price will experience increases. The stock may experience negative returns immediately following the CEO turnover and announcement however, over the long term the stock price will be higher.

Hypothesis #2: Stock price will increase more when the CEO is fired than when they step down or resign

It is also hypothesized that when the CEO is fired from the organization the stock price will appreciate and experience higher returns than when the CEO resigns or steps down from their position. This is believed because a CEO is typically fired when the company's performance is poor and investors would look positively upon this action. In addition, it is hypothesized that a CEO resigning or stepping down from a company may even cause the stock price to decline. In this case the CEO may be seen positively in the organization and investors will be concerned about a potential change in company strategy.

RESULTS

The support of Hypothesis 1 that stock price increases will be seen after a CEO turnover event. On average the stock price provides positive returns in all of the periods following the announcement of a CEO departure. The company is most likely to have negative returns preceding the turnover event and if the stock price is low prior to the announcement, this would explain why the stock price only rises once the change is announced. The greatest stock price appreciation occurs 60 days after the announcement date with an average return of almost 6%. The day of the CEO's departure on average the stock price decreases around 7% but results in a price increase after 60 days at around 1.4%. The CEO's departure seems to result in an initially negative stock price reaction due to concerns over the uncertainty of the company's future but rebounds to yield an increased price after 60 days. The P/E ratio changes one week before the announcement and departure dates as well as 60 days after. The results of this test also support hypothesis one as the percentage change 60 days after both the announcement and departure dates are positive. The average company's P/E ratio increased 12.42% 60 days after the announcement and 16.66% after the CEO's departure. This demonstrates that investors are willing to pay more for the company's stock than prior to the CEO turnover and are more optimistic about future profits.

The results also support Hypothesis 2 that the firing of a CEO results in a higher stock price reaction than when the CEO voluntarily leaves the organization. The average stock price increase for companies that fired their CEO's is 12.6%. This increase exceeds the stock price decrease that is realized with the companies CEO left voluntarily at -4%. This positive stock price reaction when the departure is forced is due to the common occurrence that a company is performing poorly when they fire their CEO. In contrast, when a CEO leaves voluntarily it may not be due to a performance issue and the CEO may be performing very well so investors are concerned about the organizations future with new leadership.

In order to test whether or not these CEO turnover events resulted in abnormal positive returns above just increases in stock price, Jensen alpha was calculated between these companies's returns and the market return in 2013.

CONCLUSIONS

In 2013 CEO turnover reached its highest level since 2008 with 1,246 companies replacing their leader. Due to the increased number of CEO departures, 2013 presented the perfect opportunity to research companies' stock price reaction to these CEO turnover events. In order to investigate this topic, 15 major CEO turnovers in 2013 from large public companies listed on the NYSE and NASDAQ were investigated. In this sample companies from various industries and with different CEO departure reasons were included. It was hypothesized that on average companies with CEO turnover would generate above average returns after the turnover event has occurred and that companies with forced CEO exits would generate higher returns that companies with voluntary exits. On average a company's stock price increased 5.93% 60 days after the CEO's departure announcement date and 1.36% 60 days after their actual departure date. In addition, company's stock prices increased 12.6% 60 days after the CEO was fired and decreased -3.99% when the CEO resigned or stepped down. These results are consistent with other research on this topic and it can be determined that companies with CEO turnover will experience stock price increases after the event.

EXHIBIT 1: GRAPH OF STOCK PRICES AROUND ANNOUNCEMENT DATE

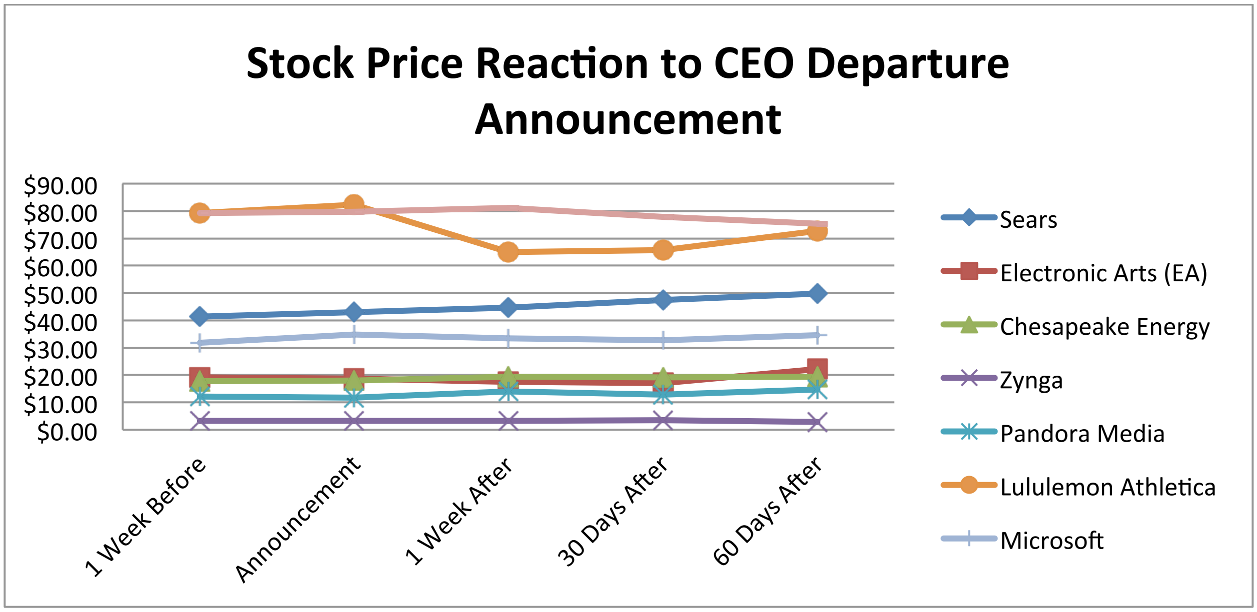

EXHIBIT 2: GRAPH OF STOCK PRICES AROUND DEPARTURE DATE

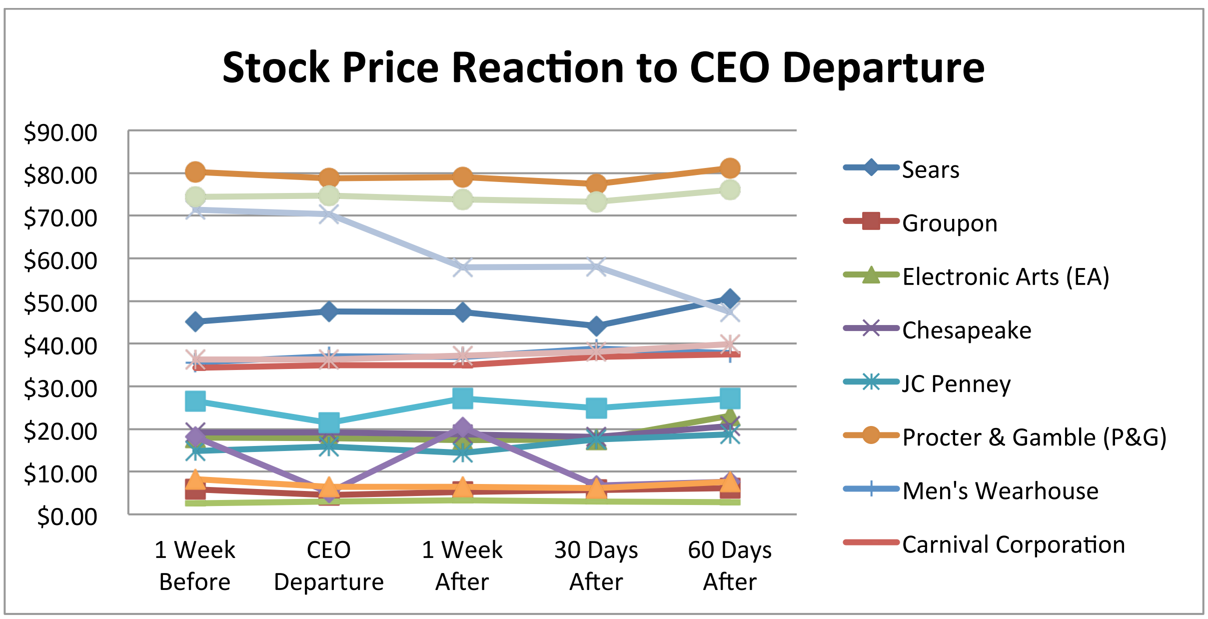

EXHIBIT 3: STOCK PRICE REACTION TO CEO DEPARTURE

Percentage Change in Stock Price Around Departure					
Company	**1 Week Before**	**CEO Departure**	**1 Week After**	**30 Days After**	**60 Days After**
Sears	$45.12	$47.55	$47.42	$44.17	$50.58
Change		**5.39%**	**5.10%**	**-2.11%**	**12.10%**
Groupon	$5.80	$4.53	$5.32	$5.69	$6.10
Change		**-21.90%**	**-8.28%**	**-1.90%**	**5.17%**
Electronic Arts (EA)	$17.97	$17.92	$17.35	$17.61	$23.16
Change		**-0.28%**	**-3.45%**	**-2.00%**	**28.88%**
Chesapeake Energy	$19.25	$19.25	$18.68	$18.16	$20.66
Change		**0.00%**	**-2.96%**	**-5.66%**	**7.32%**
JC Penney	$14.80	$15.87	$14.39	$17.61	$18.73
Change		**7.23%**	**-2.77%**	**18.99%**	**26.55%**
Procter & Gamble (P&G)	$80.20	$78.80	$79.09	$77.43	$81.22
Change		**-1.75%**	**-1.38%**	**-3.45%**	**1.27%**
Men's Wearhouse	$35.59	$37.04	$36.85	$38.89	$37.75
Change		**4.07%**	**3.54%**	**9.27%**	**6.07%**
Carnival Corporation	$34.31	$34.89	$34.88	$36.91	$37.48
Change		**1.69%**	**1.66%**	**7.58%**	**9.24%**
Zynga	$2.58	$3.07	$3.29	$2.98	$2.83
Change		**18.99%**	**27.52%**	**15.50%**	**9.69%**
Nokia	$18.16	$5.12	$20.35	$6.71	$7.62
Change		**-71.81%**	**12.06%**	**-63.05%**	**-58.04%**
Pandora Media	$26.55	$21.38	$27.15	$24.90	$27.15
Change		**-19.47%**	**2.26%**	**-6.21%**	**2.26%**
BlackBerry	$8.32	$6.50	$6.49	$6.14	$7.61
Change		**-21.88%**	**-22.00%**	**-26.20%**	**-8.53%**
Lululemon Athletica	$71.40	$70.34	$57.88	$58.02	$47.38
Change		**-1.48%**	**-18.94%**	**-18.74%**	**-33.64%**
Microsoft	$36.27	$36.35	$37.17	$38.15	$39.87
Change		**0.22%**	**2.48%**	**5.18%**	**9.93%**
Walmart	$74.42	$74.68	$73.75	$73.26	$76.02
Change		**0.35%**	**-0.90%**	**-1.56%**	**2.15%**

EXHIBIT 4: AVERAGE STOCK PRICE REACTION TO DEPARTURE ANNOUNCEMENT

	Announcement	1 Week After	30 Days After	60 Days After
Stock Price Change	1.15%	1.34%	0.38%	5.93%

EXHIBIT 5: STOCK PRICE REACTION TO CEO DEPARTURE ANNOUNCEMENT

Percentage Change in Stock Price Around Announcement					
Company	**1 Week Before**	**Announcement**	**1 Week After**	**30 Days After**	**60 Days After**
Sears	$41.36	$42.92	$44.60	$47.40	$49.68
Change		**3.77%**	**7.83%**	**14.60%**	**20.12%**
Electronic Arts (EA)	$19.13	$18.71	$17.56	$17.01	$22.21
Change		**-2.20%**	**-8.21%**	**-11.08%**	**16.10%**
Chesapeake Energy	$17.72	$17.95	$19.43	$19.07	$19.31
Change		**1.30%**	**9.65%**	**7.62%**	**8.97%**
Zynga	$3.30	$3.18	$3.19	$3.39	$2.86
Change		**-3.64%**	**-3.33%**	**2.73%**	**-13.33%**
Pandora Media	$12.20	$11.73	$14.10	$12.82	$14.66
Change		**-3.85%**	**15.57%**	**5.08%**	**20.16%**
Lululemon Athletica	$79.29	$82.28	$64.96	$65.69	$72.58
Change		**3.77%**	**-18.07%**	**-17.15%**	**-8.46%**
Microsoft	$31.80	$34.75	$33.40	$32.74	$34.58
Change		**9.28%**	**5.03%**	**2.96%**	**8.74%**
Walmart	$79.22	$79.81	$81.01	$77.87	$75.35
Change		**0.74%**	**2.26%**	**-1.70%**	**-4.89%**