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CEO SUCCESSION AND FIRM PERFORMANCE: EVIDENCE FROM PUBLICLY LISTED MALAYSIAN FIRMS

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ABSTRACT

This study investigates the impact of CEO succession on the financial performance of publicly listed Malaysian firms. A match-paired t-test and Wilcoxon signed-rank test are used to determine if there is a change in firm performance following CEO succession. The overall results show that performance improves following post-succession. We also find significant improvement in the performance of companies that experienced forced turnovers and subsequently selected outsiders as successors. On the other hand, forced CEO turnovers that are followed by internal successions disrupt firm performance. As CEO successions impact firms' future performance, the succession planning process should be a priority for firms.

Keywords: CEO succession, post-succession performance, forced turnover, voluntary turnover, internal successor, outside successor

INTRODUCTION

CEO successions provide a means for assessing the efficacy of a leader in shaping a firm's fortunes. As noted by Davidson III, Tong, Worrel and Rowe (2006), leadership is an important component of a successful corporate governance mechanism, which can enhance firm performance. The effect of CEO successions on firm performance is still debated, despite numerous studies and renewed attention to this problem (e.g., Allen, Panian, & Lotz, 1979; Brown, 1982; Friedman & Singh, 1989).

Because of the importance of the CEO as the person who is responsible for setting organisational strategy, structure, environment and performance, the central concept of the business in any organisation originates from the CEO. According to Dalton and Kesner (1985), many financial periodicals, including Business Week, Forbes, Fortune and the Wall Street Journal, provide evidence that practitioners

and analysts agree that CEOs are the individuals responsible and accountable for setting organisational strategy, structure, environment and performance. Because CEOs significantly influence their organisations, any changes in the CEO position will significantly affect investors' perceptions, thus affecting the future of the firm.

Previous studies have shown mixed results regarding the impact of CEO successions on firms' subsequent performance. For instance, Friedman and Singh (1989) show that market reactions towards CEO successions are positive when pre-succession performance is poor. On the other hand, when the pre-succession performance has been positive, the reactions have been negative. A study conducted by Korn/Ferry International on 132 Fortune 500 companies that underwent CEO successions from 2003 to 2005 revealed that a majority of these companies performed more poorly than companies that did not have CEO successions (Ghazali, 2012). Ghazali believes that the performance of companies not only depends on the knowledge and experience of an incoming CEO but also on the due diligence of the board in selecting a successor that aligns with the company's vision, goals and strategy and who fits the culture of the company. There are several socio-political factors that determine the post-succession performance of companies. The profile of the CEO does not solely determine post-succession performance.

Davidson III, Nemec, Worrell and Lin (2002) find that the stock market reacts more positively if the new CEO is an outsider and comes from an industry related to the firm's operations. Meanwhile, Chung and Rogers (1987) find that in poorly performing firms, the selection of either an insider or an outsider does not significantly influence firms' post-succession performance. This is because investors do not believe that a change in CEO will improve the firm's future performance.

The above inconclusive results can be explained with respect to three views: common sense, vicious circle and ritual scapegoating (Davidson III, Worrel, & Cheng, 1990, Kesner & Sebora, 1994). The common sense notion popularised by Guest (1962, as cited in Davidson III et al., 1990) proposes that new leaders can cause positive changes in organisations and that post- succession performance will improve once an ineffective CEO is replaced. This is because the successor is an expert who can enhance the performance of a company. On the other hand, the vicious circle view predicts that the post-succession performance of a firm will become more disruptive because the succession of its CEO will destroy the fit between the firm and its environment, including its internal authority relationship. Finally, advocates of the ritual scapegoating view believe that a change in leadership will not affect firm performance because dismissals are a form of scapegoating and managers have nothing to do with poor performance. A

succession is a signal to outsiders that changes are taking place in an organisation (Kesner & Sebora, 1994).

To the best of our knowledge, except for Ishak, Ku Ismail and Abdullah (2012), and Ishak and Abdul Latif (2012), little is known about CEO turnovers and successions in Malaysia, particularly concerning the effect of CEO successions on firm performance. Ishak et al. (2012) examine the determinants of CEO turnovers and do not consider the events that follow, that is, post-succession events. The study provides evidence that turnovers are associated with, among other factors, poor company performance. On average, a CEO occupies his or her position for nine to 10 years before being replaced. Ishak and Abdul Latif (2012) go one step further by conducting an event study examining the impact of CEO succession on the share price of Malaysian listed companies. They find that the market is indifferent on the date of announcement but that there is an abnormal return of 1.5% 10 days before the announcement. This study extends the work of Ishak et al. (2012) by examining CEO successions and events that occur following the vacancy of the CEO position. Because turnovers are generally the result of poor performance, our study examines whether new CEOs can enhance company performance. In particular, we examine whether a CEO's origin and the nature of the turnover is associated with post-succession performance. Our study differs from that of Ishak and Abdul Latif in that we measure firm performance by return on assets (ROA) and Tobin's Q, which both consider the long-term effects of successions. This study contributes significantly to the body of knowledge on CEO succession. It will serve as an important input for company boards in selecting new CEOs and effectively implementing their succession plans.

A CEO successor can be selected from within the company (insider) or from outside the company (outsider). Furthermore, the succession can be an outcome of either a forced or voluntary turnover. These factors may affect post-succession performance differently. The objective of this study is to examine the effect of CEO succession on the post-succession performance of listed companies in Malaysia. In particular, we examine whether the origin of the successor (internal versus external) and type of turnover (forced versus voluntary) impacts firm performance. Malaysia is an interesting jurisdiction for the study of CEO successions. First, there has been a growing number of CEO successions in Malaysia in recent years, and these events often receive great public attention. Nevertheless, studies on CEO successions in Malaysia are relatively limited. This study is also in line with the call for companies to plan their CEO successions, as leadership is important in determining company performance. A majority of related studies have been conducted in developed countries. To fill the gap, we feel that this study should be conducted in a country with an emerging economy, such as Malaysia. Second, the concentrated ownership of many Malaysian firms by families, a characteristic unique to the country's business environment, makes

Malaysia an interesting jurisdiction for the study. As many companies are family owned, we expect that internal CEO successors would be more common than external ones.

The remainder of this paper is organised as follows. Having discussed the background and literature related to this study, the development of hypotheses is discussed in the following section. The subsequent section presents the paper's research methods. A discussion of the results and conclusions follow.

HYPOTHESES DEVELOPMENT

Brown (1982) discusses two main factors that influence post-succession performances: poor pre-succession performance and successor origin. Past performance determines the choice of a successor and the choice of a successor influences the subsequent performance of a company. Furtado and Karan (1990), in their summary of empirical evidence of management turnover, discuss the type of turnover that influences firms' post-succession performance. The researchers claim that changes in CEO teams are of great interest to primary stockholders. Markets will respond to the changes as a signal of gain or loss in human capital or as a response to CEO changes themselves.

Pre-succession Performance

Pre-succession performance indicates how well organisations have used their resources. Poor performance provides a motivation for organisations to make drastic changes to their strategies and structures, and good performance indicates the stability and continuity of resource allocation decisions (Friedman & Singh, 1989). Past performance, which is either measured by the long-term profitability of accounting performance or by upward movement in stock prices, significantly influences the selection of successors.

A poor pre-succession performance signals that a firm must take corrective action to avoid internal or external corporate controls. A number of studies reveal that the selection of an outside candidate is the optimal solution for improving poor pre-succession performance (Friedman & Singh, 1989). By using stock market reactions as a performance indicator, Friedman and Singh find that when pre-succession performance is low, stockholders' reaction towards succession is positive and high. It is argued that an outsider will bring new and fresh ideas to the company, which will lead to significant changes in the company's strategies and policies (Furtado & Karan, 1990; Zinkin, 2010). As a result, the subsequent performance of the firm improves.

In contrast, it is argued that a firm that has above average pre-succession performance tends to select an insider to maintain the status quo of the company. Dividing firms into high-performers and low-performers, Chung and Rogers (1987) find that high-performing firms that appointed insiders tend to perform better than high performers that appointed outsiders. However, the difference is not statistically significant.

Successor Origin

In CEO succession studies, the origin of the successor has been identified as a critical variable affecting firm performance (Kesner & Sebora, 1994). There are two pertinent questions that must be answered by the board of directors when making a decision regarding the origin of a successor. The first question relates to the quality of the successor and the second question to how suitable the successor is for the board members' personal interests (Lauterbach, Vu, & Weisberg, 1999).

Salancik and Pfeffer (1980) contend that the appointment of CEOs from within the organisation represents a maintenance strategy. The new internal CEO will maintain the current strategies because he or she may be the one who was involved in establishing those strategies. However, some researchers (e.g., Cannella & Lubatkin, 1993 and Lauterbach et al., 1999) argue that the selection of an insider is only suitable for well-performing firms and that under-performing firms often need to hire external CEOs because they are more likely to be able to change the company's existing strategies and evaluate its problems.

According to Khurana (1998), an outside candidate is only appointed after a thorough search. A candidate with an impressive track record is a testimony that he or she is superior to other internal or external candidates. Furthermore, for under-performing firms, outsiders are more preferable than insiders because the board expects that they will be more likely to take decisive actions to improve the firm's situation. This view is supported by Karaevli (2007), who finds that external CEOs improve firm performance in poorly performing firms. However, Chung and Rogers (1987) provide evidence that the selection of insiders or outsiders by under-performing firms does not significantly influence the stock market. This evidence contradicts the belief that an outsider will turn around a poorly performing operation. This evidence also shows that the market does not view an outsider as a person with the right capabilities. Evidently, investors do not believe that a change in leadership will alter the declining profitability of a poorly performing firm.

It is also argued that insiders are slow in recognising the urgency of the current problem and may pursue old strategies that are no longer effective (Chung and Rogers, 1987). Lauterbach et al. (1999) state that an inside selection deteriorates post-succession performance. Based on average excess return as a

performance indicator, the researchers find a significant difference between pre-succession and post-succession performances. For an internal succession, the post-succession performance decreases by 41% (from a pre-succession excess return of 13% to a post-succession excess return of –28%). In contrast, for the outside selection, the post-succession performance increases by 35% (from a pre-succession performance of –39% to a post-succession performance of –4%). Their results indicate that external successions preclude the firm from further deterioration by turning it around and helping it get back on track.

Turnover Type

Furtado and Karan (1990) argue that only organisations that have proper succession plans can be profitable in subsequent periods. The researchers further argue that different types of turnover have different impacts on post-succession performance, such as stock price reactions. Previous research classified turnover into two types: voluntary turnover and forced turnover.

Voluntary turnover

Voluntary turnover is defined as change that takes place due to the retirement of a CEO between the age of 54–55, illness or death, or the replacement of the CEO due to mergers or takeovers (Kang & Shivdasani, 1995; Denis, Denis, & Sarin, 1997; Maury, 2006). Voluntary turnover is usually planned. Thus, it usually does not significantly affect a firm's share price movement. Customary retirement is an example of a planned change whereby a CEO announces his intention to step down at some future date. In fact, Evans, Nagarajan and Schloetzer (2010) show that an incumbent CEO is more likely to be retained on the board for an extended period of time if the firm's prior performance is good enough to ensure a smooth transition of power. As the change is anticipated, the successor has already been determined and groomed within the firm. As stated by Friedman and Singh (1989), planned retirements are generally smooth transitions that involve successors who are well known to the incumbent management.

Because the market is aware of the anticipated replacement of the CEO, it does not significantly react to the announcement of the incoming CEOs (Rhim, Peluchette, & Song, 2006). Denis and Denis (1995) show that normal retirement is not related to lower performance prior to management change and that a small improvement in performance usually follows such a succession. However, Salas (2010) finds that the stock price reaction is strongly positive if the senior executive's tenure exceeds 10 years, an indicator of managerial entrenchment.

Forced turnover

Weisbach (1988) defines forced turnover as turnover that results from reasons other than customary retirement. However, identifying forced turnovers is difficult because publicly available sources do not identify them as such. Thus, prior poor performance is taken as a proxy that triggers a forced turnover.

Generally, forced turnovers of CEOs are divided into two types: board-initiated turnovers and CEO-initiated turnovers. Markets react differently to turnovers initiated by company boards compared to turnovers initiated by CEOs (Furtado & Karan, 1990). Friedman and Singh (1989) argue that board-initiated successions are more likely to occur as a result of poor performance. Thus, a positive stock market reaction is expected from a board-initiated succession. Board-initiated successions are not likely to occur in high performing firms. However, if this is the case, it can be interpreted as some internal political turmoil in the company rather than that the CEO failed to perform his or her duties. Therefore, board-initiated succession is not well-received in high-performing firms.

The second type of forced turnover is CEO-initiated succession. Examples of CEO-initiated successions are the illness or death of the CEO. Worrell, Davidson III, Chandy and Garrisson (1986) document a negative stock market reaction in response to the announcement of a sudden death of a CEO. Furthermore, they find that there is an offsetting positive stock market reaction when an insider is appointed following a CEO's death. Placing an insider into the deceased position signals a continuity of the firm and that the situation is under control. Davidson III et al. (2006) reveal that when a firm announces the illness of its CEO and replaces the CEO with an insider, the abnormal return is negative and significant. In contrast, when the board replaces the ill CEO with its chairman or a former CEO, the abnormal return is positive but only marginally significant.

Friedman and Singh (1989) predict that CEO-initiated turnovers will lead to a positive market reaction, but at a level lower than that of board-initiated turnovers. Meanwhile, when a firm's pre-succession performance is positive, CEO-initiated turnovers will either signal that the CEO wishes to change his organisational affiliation or position and market himself to external parties. A negative market reaction is expected due to unwelcome change and disruption in external relations and the patterns of authority initiated in the departing CEO's interest.

In summary, Brown (1982) and Furtado and Karan (1990) discuss three main factors that influence the consequences of CEO succession: prior performance, turnover type and the origin of the successor. Friedman and Singh (1989) claim that a firm's poor past performance provides the motivation to change

its existing strategies and policies to meet its challenges. The researchers show that past performance has a significant and negative effect on stockholders' reactions. Additionally, the selection of the successor, whether externally or internally, has become a crucial issue in poorly performing firms. Chung and Rogers (1987) claim that the replacement does not have a significant influence on a firm's subsequent performance. In contrast, based on their findings, Cannella and Lubatkin (1993) and Karaevli (2007) suggest that an outsider is the best candidate for turning around a firm's poor performance. Further, Furtado and Karan (1990) argue that type of turnover, whether forced turnover or voluntary turnover, also has a significant impact on the performance of firms. Voluntary turnover shows a small performance improvement, whereas forced turnover contributes to positive market reactions regarding the announcement of the management turnover (Friedman & Singh, 1989; Denis & Denis, 1995; Rhim et al., 2006).

According to the common sense view, changes in firms' CEOs are expected to improve firm performance, especially that of poorly performing firms. Poorly performing firms tend to dismiss their underperforming CEOs and replace them with external candidates. It is argued that these external successors can improve firms' future performance by introducing new strategies and policies to enhance the value and image of the firms. Thus, based on common sense theory, it is expected that changing CEOs who are responsible for poor past performance with outsiders will contribute to better performance in the future. Based on the foregoing discussion, the following hypotheses are proposed:

H1: CEO succession improves firms' post-performance.
H2: CEO forced turnover improves firms' post-performance more than voluntary turnover.
H3: Outside CEO successors improve firms' post-performance more than inside CEO successors.
H4: CEO forced turnover that is followed by external selection of a successor improves firms' post-performance more than CEO turnover, which is followed by inside selection.

RESEARCH METHODS

The data consist of all of the companies listed on the Main Board and the Second Board of Bursa Malaysia that changed their CEOs between 2002 and 2005. There were 258 cases of CEO succession during the period. However, after omitting MESDAQ (Malaysian Exchange of Securities Dealing and Automated Quotation) companies (4), delisted companies (28), financial institutions (6), companies with incomplete financial data (26), companies whose annual reports are inaccessible (12), companies whose CEO changed more than once (33), companies with joint

CEOs (2) and companies experiencing mergers and take-overs (2), 145 succession events were included. To estimate post-succession effects, the two-year post-succession performance was analysed to determine changes in firm performance after succession events.

Post-succession performance refers to changes in firms' ROA and Tobin's Q. A two-year performance after succession is compared to the mean performance of two years before the CEO turnover. Differences in both the mean and median of these performance measures indicate whether the CEO succession improves, disrupts or has no effect on the firm's post-performance. Successor origin is classified into either insider or outsider, and the type of turnover is classified into forced or voluntary.

To determine any improvement or disruption in post-succession performance, both the mean and median of performance in the post-succession years are compared with the previous performances. The comparison is conducted for three categories: all samples, turnover type and successor origin. A match-paired t-test and Wilcoxon Sign Rank Test are used to examine the difference in mean and median of firm performance before and after CEO successions. The performance is measured by firms' ROA and Tobin's Q. The change in the performances is calculated as performance of the later year minus the two-year average performance before the succession. Data on the firm's past performance and post-performance are collected for the period of two years before and two years after CEO successions. For example, if the turnover occurred in 2002, data from 2000 to 2004 are collected. The selection of two years before successions is based on the argument made by Boeker (1992) that the turnover of a CEO does not happen immediately after poor performance. At least two years of consecutive poor performance is the best indicator for determining when to dismiss an underperforming CEO.

The classification of forced turnover and voluntary turnover is based on the reason stated in the change of management announcement made by a company on Bursa Malaysia's website. The classification used is suggested by Huson, Malatesta and Parrino (2004), and Dahya, McConnell and Travlos (2002). They labelled a turnover as a forced turnover when news articles stated that an executive was "fired" or had "resigned". In both cases, the CEO had to be less than 55 years old. In addition, if the announcement did not report any reason for the departure, such as death, poor health, or the acceptance of another position inside or outside the firm, the departure was classified as forced turnover. Furthermore, removal was considered forced turnover if CEOs were removed before the expiration of their three-year terms (Kang, 2002).

RESULTS

Table 1 shows the distribution of companies according to turnover type and CEO origin. Of the 145 CEO succession events, 83 events (57.2%) are the outcome of forced turnovers, and the remaining 62 events (42.8%) are due to voluntary turnover. Whereas 74 of the companies selected insiders as CEO successors, 71 companies selected outsiders as successors. Table 1 also shows that in forced turnovers, successors are more likely to be outsiders, and in voluntary turnovers, successors are more likely to be insiders.

Table 1
Distribution of companies by turnover type and CEO origin

Turnover type	Successor origin		
	Insider	Outsider	Total
Forced turnover	31 (41.9%)	52 (73.2%)	83 (57.2%)
Voluntary turnover	43 (58.1%)	19 (26.8%)	62 (42.8%)
Total	74 (100%)	71 (100%)	145 (100%)

Table 2 shows the distribution of companies by some selected company characteristics and the origin of successors. We observe that large companies, represented by Main Board companies, are more likely to have outside successors compared to their smaller counterparts. In Main Board companies, 55 (53%) CEOs were replaced by outsiders. Meanwhile, of 41 successions at Second Board companies, only 16 (39%) successors were outsiders compared to 25 (61%) insiders. This may be because Second Board companies are more likely to be family-owned businesses and thus are expected to retain family members as CEOs. Table 1 also shows that firms in most industries choose insiders as successors except for those in the consumer products sector, which prefer outsiders as successors. Out of the 28 consumer products firms, 20 of them (71%) selected outside successors. Again, this may be because family businesses are more likely to be involved in consumer products. In addition, we observe that outside successors outnumbered inside successors in 2002 and 2004. On the other hand, insiders were preferred as successors in 2003 and 2005. As far as firm performance is concerned, Table 2 reveals that insiders and outsiders are approximately equally distributed between low- and high-performing firms.

As expected, we provide evidence that an outside successor is not welcome in family-and management-controlled firms. Of 41 successions involving family-controlled firms, only 9 (22%) of the incoming CEOs were outsiders. In contrast, of 104 successions of non-family firms, 62 companies (60%) chose outsiders as successors. Similarly, from 98 successions in management-controlled firms, only

39 (40%) were selected from external sources. Another 59 companies (60%) selected insiders as their new CEOs.

Table 2
Firm characteristics

Items	Outsiders (71 cases)	Insiders (74 cases)	Total (145 cases)
Board listing			
Main Board	55	49	104
Second Board	16	25	41
Sector			
Industrial products	20	24	44
Trading	17	23	40
Consumer products	20	8	28
Properties	5	6	11
Construction	4	5	9
Plantation	2	2	4
Technology	0	4	4
IPC	2	1	3
Hotel	1	1	2
Succession Year			
2002	21	16	37
2003	12	17	29
2004	21	19	40
2005	17	22	39
Performance			
Low (negative average ROA)	18	19	37
High (positive average ROA)	53	55	108
Ownership			
Family	9	32	41
Non-family	62	42	104
Managerial	39	59	98
Non-managerial	32	15	47

Table 3 displays the overall results of firms' post succession performance by CEO origin and turnover type. The significance of the differences in mean and median of both ROA and Tobin's Q is determined based on a paired-t-test and Wilcoxon Sign Rank test, respectively. Changes in ROA (Tobin's Q) are measured as the difference between ROA (Tobin's Q) at the end of the latter year and the average ROA (Tobin's Q) in years $t - 1$ and $t - 2$. For example, a change in ROA for the period "pre-succession" to $t + 1$ is measured as ROA_{t+1} minus $ROA_{average\ of\ t\text{-}1\ and\ t\text{-}2.}$

Table 3
Changes in firm performance surrounding CEO succession

Means are presented above medians. Significance of mean and median changes are measured using a standard two-tailed pair t-test and a two-tailed Wilcoxon signed-rank test, respectively.

Year	All Successions $n = 145$		Forced turnover $n = 83$		Voluntary Turnover $n = 62$		Outside Selection $n = 71$		Inside Selection $n = 74$	
	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q
Pre-succession to t0	0.007	–0.045	–0.005	–0.025	0.023	–0.072**	0.010	0.023	0.004	–0.111***
	0.003	–0.032**	0.001	–0.019	0.005	–0.050**	0.010	–0.008	–0.004	–0.064***
Pre-succession to $t + 1$	0.011	–0.033	0.004	0.032	0.022	–0.119**	0.024	0.063	–0.000	–0.125***
	–0.002	–0.028	–0.001	0.010	–0.004	–0.052**	0.007	0.033	–0.009**	–0.071***
Pre-succession to $t + 2$	0.044*	0.018	0.044	0.090	0.044	–0.077	0.056	0.173*	0.033	–0.130**
	0.001	–0.001	0.004	0.004	–0.004	–0.022	0.019*	0.049*	–0.005	–0.050**

Note: ***$p < 0.01$, **$p < 0.05$, *$p < 0.10$

Overall, Table 3 shows that there is an improvement in post-succession performance. The mean of the ROA increases significantly two years after succession events, showing an increase of 0.044 from the pre-succession period. Thus, this finding supports our hypothesis that CEO succession improves firms' future performance (H1). The finding also agrees with the common sense view, which posits that post-succession performance will improve once an ineffective CEO has been replaced. The selected incoming CEO would be someone who can turn the company around. However, the change in ROA is not significant one year following the succession. With a new given task, a new CEO would take some time to align his vision and strategy with those of the company, and improvements will only be realised at least two years after taking over the helm. We also observe that the change in Tobin's Q in years 1 and 2 is not significant, although the market reacts negatively immediately after the successions occur, as shown by a significant negative change of 0.032 in the median score.

A closer look at the overall forced turnover (without grouping into insiders or outsiders) reveals that there is no significant change in post-succession performance. Thus, H2, which states that forced CEO turnover improves firms' future performance, is not supported. However, if we compare forced and voluntary turnovers, forced turnovers are better received by the market. At the very least, the market is indifferent and does not act negatively when there is a forced turnover. On the other hand, as far as overall voluntary turnover is concerned, the changes in Tobin's Q mean and median show that the market reacts negatively to voluntary turnovers, significantly so in the year of succession and one year after

succession. This finding does not support Denis and Denis (1995) and Rhim et al. (2006). Rhim et al. argued that the market is aware of the expected replacement of the CEO and thus would not significantly react to the CEO's replacement. Friedman and Singh (1989) argue that in a voluntary turnover, the transition should be smooth because it involves successors who are well-known to management. Although H2 is not supported, the market perceives that in a forced turnover, a company would be careful to select a new CEO who could perform better than the outgoing CEO. Thus, the market would not react negatively.

Table 3 also shows that the post-succession performance of firms whose incoming CEOs are outsiders improves significantly two years after succession, either in the ROA (an increase in median of 0.019) or Tobin's Q (an increase in mean and median of 0.173 and 0.049, respectively). The finding supports Khurana (1998), who argues that outsiders are only appointed after a thorough search and that a candidate with an impressive track record is an indication that he or she is the best choice. As in the case of insiders, post-succession performances are worse than before, particularly when Tobin's Q is used as a measure of performance. The significant negative changes in the mean and median shown in the last two columns of Table 3 indicate that the market is not in favour of insiders. This may be because insiders are not sufficiently pro-active and do not have the required sense of urgency to deal with the problematic situation at hand. As noted by Chung and Rogers (1987), insiders may continue using existing strategies that are no longer effective. Our results also agree with those of Lauterbach et al. (1999), who show that post-succession excess returns decline following the internal selection of a CEO and improve following the external selection of a CEO. Our findings support H3 in which we propose that external CEOs improve firms' post-performance more than internal CEOs.

In our analysis, we divide our sample into two groups – forced turnovers and voluntary turnovers. For each sub-sample, we examine the consequences of selecting either an insider or an outsider as the CEO. Table 4 gives a closer view of the difference in performance of insiders and outsiders following either a forced turnover or a voluntary turnover. Under both sub-samples, we observe some glaring differences between the performance of insiders and outsiders. As for the forced turnover sub-sample, the ROAs show that outsiders can improve firm post-succession performance, while insiders cannot. The Tobin's Q results also show that performance improves in the case of outsiders and deteriorates in the case of insiders. The performance becomes more disruptive two years after insider succession. It appears that in a forced turnover, outsiders are more suited to being CEOs. Our findings agree with the arguments in favour of external CEOs (Khurana, 1998; Chung & Rogers, 1987). Additionally, our findings support H4 in that a forced CEO turnover that is followed by an external selection results in better

post-performance than a forced CEO turnover that is followed by an internal selection.

Table 4
Post succession performance based on turnover type

Year	Forced turnover $N = 83$				Voluntary Turnover $N = 62$			
	Insider $N = 31$		Outsider $N = 52$		Insider $N = 43$		Outsider $N = 19$	
	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q	Δ in ROA	Δ in Tobin's Q
Pre-succession to t0	–0.002	–0.135*	–0.006	0.041	0.009	–0.093**	0.054	–0.025
	–0.005	–0.042**	0.008	–0.005	–0.003	–0.070**	0.018*	–0.029
Pre-succession to $t + 1$	–0.019	–0.115	0.017	0.119	0.013	–0.131**	0.042	–0.090
	–0.003	–0.073	0.003	0.035	–0.018*	–0.070**	0.014	0.026
Pre-succession to $t + 2$	–0.018	–0.179**	0.081*	0.250**	0.069	–0.094	–0.012	–0.038
	–0.005	–0.094**	0.030	0.081**	–0.005	–0.019	0.016	–0.037

Note: ***$p < 0.01$, **$p < 0.05$,*$p < 0.10$

In the case of voluntary turnover, Table 4 shows that outsiders do not significantly improve the performance of companies, as shown by the insignificant change in the ROAs and Tobin's Q. However, we provide evidence that outsiders would make better CEOs, at least in the short term. This is shown by the significant negative change in the median ROA one year after succession (–0.018) and the negative changes in the mean and median Tobin's Q in the year of succession and one year after succession. Consistent with the case of forced turnovers, a firm's subsequent performance becomes more disruptive when an insider is selected as the successor following a voluntary turnover because both the mean and median of Tobin's Q are significant.

In conclusion, we find that in both forced and voluntary turnovers, external CEOs are more likely to outperform internal CEOs. Although with voluntary turnovers, outsiders do not show outstanding post-succession performance within a two-year period, the fact that they can maintain rather than disrupt firm performance is a good indication that they are adapting well to the company's strategies and policies. The maintenance of performance is expected in voluntary turnovers because they are usually not the outcome of poor performance. In contrast, the selection of insiders as successors, following either a forced or voluntary turnover, deteriorates the firm's future performance. The announcement of inside succession is viewed as a continuation of the firm's existing managerial

practices and thus does not contain any new information with regard to its future prospects.

An additional analysis is conducted to compare the change in performance between turnover and non-turnover firms, the results of which are shown in Table 5. The non-turnover firms are selected using a match-pair approach that matches the 145 turnover companies with the 145 non-turnover companies. The matching companies must be from the same market (Main Board or Second Board) and the same industry and have a similar size.

Table 5 shows that for turnover firms, there is a small increase in ROA two years after CEO succession. In contrast, when Tobin's Q is used as the performance measure, the change in performance is not significant. Similarly, the performance of firms that do not change their CEOs does not change. Likewise, Tobin's Q also shows that the performance of non-turnover companies does not significantly change.

Table 5
Changes in performance-turnover and non-turnover companies

Year	Turnover companies, N = 145		Non-turnover companies, N = 145	
	ROA	Tobin's Q	ROA	Tobin's Q
Pre-succession to t0	0.007	–0.045	0.001	–0.039**
	0.003	–0.032**	–0.001	–0.036
Pre-succession to t+1	0.011	–0.033	0.002	–0.041
	–0.002	–0.028	0.005	–0.030
Pre-succession to t+2	0.044*	0.018	0.007	–0.019
	0.001	–0.001	0.004	0.002

Note: ***$p < 0.01$, **$p < 0.05$,*$p < 0.10$

Overall, when comparing the performance between turnover and non-turnover companies, both groups of company show an incremental increase in performance. However, the change in the performance of turnover companies is more than the change in non-turnover companies. Thus, changes in companies' CEOs can increase firm performance because investors view the succession events as corrective actions taken by companies to improve the firms' future performance.

We also conduct robustness tests to observe the companies' performance during the first two years after succession. Regression tests are conducted to determine whether the origin and type of turnover would have any influence on the post-succession ROA and Tobin's Q while controlling for firm size, leverage and diversification. The results are presented in Table 6.

Table 6
Robustness Tests – Regression results

	ROA		Tobin's Q	
	Coefficients	*t*-values	Coefficients	*t*-values
Constant	–.315	–2.920***	.781	1.353
Origin	–.068	–2.098**	.351	2.016**
Turnover type	–.030	–.762	.039	.183
Leverage	.001	2.302**	.010	4.116***
Business Diversification	–.014	–2.036**	–.093	–2.557**
Company size	.068	3.531***	.030	.288
Origin*Turnover type	.076	1.433	–.168	–.594
Adj. R^2	.084		.124	
F	3.208***		4.410***	

Notes: ***$p < 0.01$, **$p < 0.05$,*$p < 0.10$; Origin = 1 if an outsider, 0 if insider; Turnover type = 1 if forced turnover, 0 if voluntary; Leverage = Total liability/ Total Assets; Business diversification = Number of business segments; Company size = Natural log of total assets; Origin*Turnover type = Interaction of origin and turnover type; ROA = Average return on assets two years after succession, $(ROA_{t+1} + ROA_{t+2})/2$; Tobin's Q = Average Tobin's Q two years after succession, $(Tobin_{t+1} + Tobin_{t+2})/2$

The results show that insiders outperform outsiders during the period two years after succession. One reason that may explain this result is that the period is not long enough for the new external CEO to take corrective actions to improve firm performance compared to insiders who are already familiar with the affairs of the company. External CEOs may need some time to restructure the firm and plan other strategic actions to overcome firm underperformance. Another reason that insiders outperform outsiders during the period two years after succession is that a new CEO may take a "big bath" so that he or she can blame the company's poor performance on the previous CEO and take credit for the following year's performance (Yu, 2013).

Nevertheless, our findings show that outsiders outperform insiders when Tobin's Q is used as a performance measure. This implies that investors perceive the hiring of external successors as good news; thus, they react positively towards the appointment of external CEOs. Investors may view the selection of an outsider as a corrective action taken by companies to improve the firm's future performance.

Our findings also reveal that large firms perform better than their smaller counterparts in terms of ROA and that less-diversified firms perform better than more diversified ones in terms of both performance measures. In addition, highly

leveraged firms perform better than low-leveraged firms in both models. However, we do not find any association between type of turnover and firm performance in either the ROA or the Tobin's Q models. The performance of companies in both forced and voluntary turnover groups does not differ.

CONCLUSION

The main objective of this paper is to examine the effect of CEO successions on firms' post-succession performance. This study finds that, on average, firms' post-succession performance slightly improves following CEO successions and that the improvement is significant two years after succession. There is no significant improvement in firm performance in the case of forced turnover. On the other hand, voluntary turnovers exhibit a drop in post-succession performance one year following CEO succession. Firms that select outsiders as successors improve their post-succession performance, and firms that select insiders as successors show a negative post-succession performance. In conclusion, post-succession performance improves when firms force a turnover and select outsiders as successors. Meanwhile, firms that are involved in either forced or voluntary turnovers and select insiders as successors face poorer future performance. Poor post-succession performance by internal CEOs compared to external CEOs implies that a proper CEO succession plan is lacking among Malaysian companies. The process of grooming suitable candidates should start early rather than wait until an outgoing CEO leaves a company. Companies should also be ready for the unexpected situations in which a CEO may be dismissed due to poor performance or illness.

Our study suggests that hiring a CEO from outside the company can improve firm performance. Companies should be brave enough to make the shift for the betterment of the company when inside expertise, talent and capability are limited. This may be the case in family-owned or management-owned companies in which the owners are not willing to let outsiders run their companies. Meanwhile, the small increase in performance following a CEO succession does not indicate that CEO leadership is insignificant. CEOs are always important because they have significant influence in determining a firm's goal, strategies and use of resources. However, only exceptional CEOs are capable of counteracting the momentum of a firm's performance.

The fact that we observe the performance of firms only two years after succession is a limitation of this study. Observations of firm performance over a longer term would be more meaningful. Other than the nature of turnovers (forced or voluntary), other factors, such as successor characteristics, environmental turbulence, and governance and ownership structure, may influence the relationship between CEO origin and firm post-succession performance. As far as

ownership is concerned, it would be interesting to observe whether a new family or non-family CEO would influence a firm's post-succession performance. Thus, we propose that future studies should examine these issues, perhaps by using a more rigorous method, such as multivariate analysis.

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