THE BUY OR BUILD DECISION IN SELECTING A CEO'S SUCCESSOR: A QUANTITATIVE ANALYSIS OF NEW CEO ORIGIN AND SUBSEQUENT CORPORATE FINANCIAL PERFORMANCE OF *FORTUNE* 500 COMPANIES

by

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Abstract

CEOs' origin has been viewed by many scholars and researchers as important succession characteristic (Shen & Cannella, 2002), yet there is limited unified research findings on the topic. This research effort resulted from the quest toward further understanding of the relationship between new CEO successor origins and subsequent organizational outcomes. Many organizational researchers in recent years have devised various paradigms to help understand the relationship between new CEO successor origins and subsequent organizational performance. However, prior studies have yielded mostly inconsistencies and confusions with limited theoretical advancement, which partly resulted from inappropriate sample sources and technological constraints in collecting the required financial data (Bommer & Ellstrand, 1996; Murphy, 1999). This study benefited from current advancements in informational technology, which has made better collection of relevant financial data across many firms possible. This study specifically focused on the implications of new CEO successors' origins and subsequent organizational financial outcomes of *Fortune* 500 companies. The main population for this study comprised of U.S. firms listed in the calendar year 2003 *Fortune* 500 companies. The study sample consisted of *Fortune* 500 companies, which have experienced a CEO succession event during the period from 2003 to 2005 as evidenced by changes in the identity of CEOs listed during same period. The researcher employed current and relevant financial data reported by the *Fortune* 500 companies over the period from 2003 through 2007. The financial data used in the study analysis represented two relevant periods: the year prior to a CEO succession event (Yr-1) and the consecutive two-years following a CEO succession event (Yr+1 & Yr+2). The study employed

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Accounting-Based variables to measure post-succession organizational financial performance. Findings from this study suggest that outsider new CEO successors are as capable as insider new CEO successors in moving the organization forward with limited or no interruptions. In addition, the theory and evidence from this study suggest that new CEO successor origins do not significantly influence post-succession financial outcomes of *Fortune* 500 companies.

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Dedication

This dissertation is wholly dedicated to my parents, my wife, and to my children. To my parents, because they instilled in me the courage to endure and conquer even when the task particularly seems impossible. To my wife, who stands by me through it all, she is always there, encouraging and reassuring me with her soft but firm voice that echoes through my senses. Finally, to my children, because they re-energized me to pursue my ultimate dream and, most particularly, for the uncanny understanding of my two youngest daughters: Adeshola and Folasade. Thank you.

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CHAPTER 1. INTRODUCTION

Introduction to the Problem

Change is an essential component of firms; this is particularly true in the 21st century global marketplace. Change has become the prevalent vernacular among scholars and practitioners in organization and management studies (Anderson & Ackerman, 2001; Camuffo, 2003; Chapman, 2002; Harrison, Torres, & Kukalis, 1988; Marshak, 2004). Changes in corporate leadership, particularly chief executive officers (CEOs), are inevitable. However, choosing the right new CEO successor who can champion effective organizational change remains a challenge (Greenwood & Hinings, 1996; Grossman & Hart, 1986; Miller, 1993; Roberto & Levesque, 2005). The decision to select a new CEO successor (insider or outsider) is likely to influence organizational strategic transformation and other process changes, which in all likelihood can significantly influence subsequent financial performance of firms (Davis, 2005).

Given the current global organizational competitiveness, it is not at all surprising that the new CEO successor selection decision is probably among the most critical and challenging event occurring in many organizations (Lorsch & Khurana, 1999). The new global economy provides organizations with critical transformational opportunities, including corporate leadership changes, aligning with major environmental archetypical patterns and sociopolitical conditions to enhance profitability and stakeholders' values

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(Byrne, 2005; Greenwood & Hinings, 1996). Most new CEO successor selection (insider or outsider) decisions are intended to help bring new leadership changes that are likely to generate fresh energies, renew organizational strategic direction, and enhance organizational abilities (Davis, 2005). More importantly, new CEO successors can effectively revamp the organizational ability to survive, and attend swiftly to both current and anticipated environmental changes (Arbnor & Bjerke, 1997; Porter, 1997). A more formidable organizational leadership paradigm often emerges from new CEO succession (Davis, 2005). Many organizational and management researchers such as Chung, Rogers, Lubatkin, and Owers (1987), Friedman and Singh (1989), among others, agreed that new CEO successor selection is among key inevitable realities which all organizations must address critically. Selecting between an insider and an outsider new CEO successor candidate is a critical organizational decision, representing an important, highly visible, and risky event, which may result in profound post-succession firm performance consequences (Kesner & Sebora, 1994).

While many organizational scholars have investigated relationships between the various attributes of new CEO successors and subsequent organizational financial outcomes widely over several decades, there are still research gaps pertaining to the topic (Dess & Picken, 2000; Vancil, 1987; Zajac, 1990). Research gaps have resulted primarily from narrow research focus, inappropriate sampling, and different sampling frames of prior studies on new CEO successor origin (Bommer & Ellstrand, 1996; Murphy, 1999). For example, when Boeker and Goodstein (1993) conducted a study to examine firm performance and new CEO successor choice, the research focused only on

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semiconductor firms. Helmich (1974) conducted similar study on presidents in 29 manufacturing firms. Virany, Tushman, and Romanelli (1992) conducted a study on top executives in 59 minicomputer firms. The apparent narrow perspectives of prior new CEO succession studies (small sample, single industry) have yielded limited theoretical advancement; these studies have also undoubtedly suffered from sampling limitations (Bommer & Ellstrand, 1996; Murphy, 1999). In addition, the small sample from a single industry approach could very well be contributing to inconsistencies in CEO succession research findings.

Clearly, prior research on new CEO succession has been characterized by mixed findings. For example, Shen and Cannella (2002) argued that the origin of the new CEO successor affects the firm's subsequent financial outcomes. Friedman and Singh (1989) argued that changes in firms' strategic components such as new CEO successor choices (insider versus outsider) could have a major influence on subsequent firm performance. Pfeffer and Davis-Blake (1986) argued that succession continues to be a complex and a risky phenomenon for organizations. Lubatkin, Chung, Rogers, and Owers (1989) argued that the decision to select an insider or an outsider new CEO successor could determine if subsequent organizational financial performance is favorable or unfavorable.

Organizations have two leadership succession strategic options where new CEOs may originate. The first option requires firms to *build* or develop their next leaders internally, by implementing a robust CEO succession planning process. The second option requires firms to *buy* their next leaders by recruiting from other organizations (Pernick, 2001). Before identifying selection considerations, some researchers agree that

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organizations should establish or define logical criteria that may help determine which CEO successor origin would be most congruent with the organizational strategic focus or more favorable to achieve the desired post-succession performance (Charan, Drotter, & Noel, 2001; Helmich, 1977; Lubatkin et al., 1989).

Generally, the expedient and probably the riskiest approach is the option to *buy* leaders by recruiting them from the outside (Pernick, 2001). A major concern with the *buy* option is transferability of leadership talents and expertise. Most of the new CEO successors bring forth new talents that may have immediate influence on the firm; however, even the best management talent may not transfer unless it can align with the strategic direction and the environments of the new organization (Groysberg, McLean, & Nohria, 2006).

Alternatively, organizations may choose the *build* option, which requires a robust CEO succession plan. Organizations selecting the *build* option also need to identify and develop a pipeline of potential future leaders. The 'build' option generally requires two things: First, organizations must have a process for selecting potential leadership candidates, and must be ready to invest necessary resources for their development. Secondly, candidates selected must be ready to invest the necessary time and energy, which could span many years (Charan et al., 2001). The 'build' option also has risks attached. There are no assurances that these future leaders can achieve or deliver favorable post-succession performance sought by stakeholders; more important, there are no guarantees of their continuing long enough with the firm to take the helm. Many insider leadership candidates have accepted leadership position offers from other

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firms (Jayne, 2003; Sarros & Santora, 2001).

Information technology constraints have generally prevented the collection of some necessary empirical evidence to carry out rigorous inquiry to determine the performance consequences of CEO successor origins. As a result, most prior CEO succession origin research has been, at best, inconclusive concerning the linkage between new CEO successor origin and firm performance (Helmich, 1977). However, current technologies now make it possible to obtain previously unavailable empirical data, which permits a more rigorous inquiry regarding the contingency theory and the linkage between critical successor attributes, including successor origins and subsequent organizational post-succession performance.

Through non-experimental relational quantitative research methodological approach (Robson, 2002) using pertinent (longitudinal) *Fortune* 500 companies' data, this study adds new information concerning whether new CEO successor origins have significant relationship to subsequent firm performance. Specifically, this study empirically analyzed relevant publicly available financial data of representative *Fortune* 500 companies; the result elucidated the extent that post-succession performance relates to new CEO successor origins.

Background of the Study

Most *Fortune* 500 companies such as Boeing, Coca-Cola, GE, TRW, and many others have traditionally relied upon internal leadership development and a robust succession planning process for strategic continuity. This type of strategy allows firms to ensure that skilled and motivated management cadres are available internally to help

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move the organization forward without interruption at the end of an incumbent CEO's tenure (Dess & Picken, 2000; Vancil, 1987). An effective succession planning process provides strategic assurance that allows current and long-term operational stability; enables firms to absorb the impact of leadership changes with minimal disruptions (Allman & Cochie, 2006). The effect of a robust succession planning process is "like passing the baton without missing a beat" (Manthey & Balhoff, 2002, p. 43).

However, because of the current global marketplace requirements and demands, organizations must be prepared to select an insider or an outsider CEO successor who is most congruent with the organizational strategic focus. Extant research findings show an increasingly large number of *Fortune* 500 companies are considering outside sources when appointing their new CEOs. For example, *Fortune* 500 firms appointed ten times more outsider CEOs in 2006 than were appointed in 1980 (Marsh, 2006). The suggestion by Helmich (1974) that an upper echelon executive may not readily transfer across companies and industries may not be as valid today as it might be in the past. There is very little evidence empirically, which suggest that selecting an outsider CEO successor can assures a firm's financial success; such action has never been proven to be a winning formula, or to produce any strategic advantages (Marsh, 2006). Dervitsiotis (1998) suggested that the adaptation needed to meet the increasing firm environmental change, "requires an increased repertoire of managerial responses" (p. 109). The contention is that organizations must embrace change; must embrace design decisions that reflect their environmental conditions, develop strategies that capture their operational intent, and seize opportunities; and most importantly, organizations must embrace a tradition of

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selecting capable leaders whether an insider or an outsider. Such a tradition has its advantages, including alleviating worries or concerns that stakeholders may have about the quality of the next corporate leader (Vancil, 1987). Industry wireless giant Motorola appointed an outsider CEO "with no experience in wireless or consumer marketing" (Lashinsky, 2004, p. 2). The aerospace industry giant Boeing, for the first time ever, appointed an outsider CEO even though there were two qualified internally nurtured candidates available. Internal candidates could have readily taken the helm in each case; however, each firm appointed the best-qualified candidate based on the condition of their respective strategic requirements (Lunsford & Karp, 2005).

A widely held contention in organizational literature is that troubled firms generally hire outsiders when an intervention by an outside talent is necessary to turn around sagging profitability or less than impressive operations (Chung et al., 1987). However, many firms have made leadership changes because it was necessary rather than because of an impending crisis (Vancil, 1987). In many instances, the firm's sociopolitical environment was the determinant of whether the new CEO successor position is offer to an insider or an outsider (Chung et al., 1987). Ordinarily, a new CEO successor comes from the inside or outside of the firm, as long as the selection decision is in the best interest of stakeholders (Vancil, 1987).

Generally, in any organization, the CEO is the top agent or the top executive responsible for creating values and maximizing stakeholder's interests in the corporation (Zajac, 1990). However, the new global economy challenges are evoking new organizational demands. Hence, many firms are facing very different and more complex

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global competitiveness, which are undoubtedly requiring a new CEO successor's selection paradigm. While the increase in the trend toward selection of outsider CEO successors may be somewhat surprising, what is more surprising is that "75 percent of organizations are not confident they have the internal capability to fill strategic leadership roles" (Jayne, 2003, p. 22). This startling statistic reflects how little many organizations consider the implications of leadership change, or how little they understand the relationship between new CEO successor origins and post-succession firm performance.

Understandably, adaptive challenges and risks are prevalent organizational realities in the contemporary global environments; among most probable means to confront such challenges are through effective leadership succession strategies (Chung et al., 1987; Friedman & Singh, 1989). Clearly, additional empirical research could prepare forward thinking organizations with the evidence they need to understand the linkage or relationship that may exist between new CEO successor origins and subsequent organizational financial performance. This study hopes to provide information that may enable the right person within organizations to understand some of the advantages and disadvantages of the succession planning process and enhance the selection decision of the new CEO successor.

Statement of the Problem

Issues pertaining to new CEO succession buy or build decision have been of vital interest to organization and management scholars and practitioners for many years (Boeker & Goodstein, 1993). However, in spite of claims by many scholars and other researchers that CEO succession can bring necessary changes to improve organizational

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outcome, what we know today about new CEO successions is mostly contradictory. As noted by Kesner and Sebora, (1994, p. 327) "There is little that we know conclusively, much that we do not know because of mixed results, and even more that we have not yet studied". For example, while many scholars and researchers have conducted various studies on the linkage between the origins of new CEOs and organizational performance, none has empirically investigated the relationship between the buy or build successor decisions and financial performance consequences of *Fortune* 500 companies.

The design and focus of this study was to improve findings and remove gaps in what we know about the new CEO successor origins and post-succession firm performance. Accordingly, this study empirically investigated the performance effects of new CEO successor selection decision; in addition, the study helped determine whether post-succession financial performance research findings are applicable in broad-based publicly held firms such as *Fortune* 500 companies. Through empirical relational quantitative research approach, this study advance the literature by providing valuable new information about the relationship between new CEO successor origins and organizational financial performance of *Fortune* 500 companies.

The changing business environments and global competition have greatly changed the complexity, focus, and how organizational strategic formulation, for example the CEO successor's selection. The competitive nature of the new global marketplace also mandates selecting the new CEO successor that is dynamic (Lubatkin, Chung, Rogers, & Owers, 1989), which can make many firms' buy or built decisions complex. New CEOs in the contemporary firm milieu must develop better strategies and

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policies, stimulate innovations, integrate and communicate new ideas, rally and engage employees, and adapt quickly to new challenges (Dess & Picken, 2000; Northouse, 2004).

The CEO successor in the new global market faces new issues and new sociopolitical challenges, which are more dynamic and more complex than in the past (Bommer & Ellstrand, 1996; Dess & Picken, 2000; Friedman & Singh, 1989). Environmental innovations, international politics, outsourcing, global competitiveness and diversification, are just a few new demands that require the selection of the right new CEO successor who can effectively navigate the new organizational milieu (Dervitsiotis, 1998). Advancements in information technologies have changed many business functionalities and skill sets, which clearly demand CEOs that have current leadership competencies and can evolve in the new complex global marketplace (Humphreys, 2001).

While some researchers have questioned what leaders really do, many have recognized leadership as the most critical organizational element and that it is necessary for the advancement and attainment of organizational objectives, financial or stakeholders' expectations, and organizational strategies (Dess & Picken, 2000; Friedman & Singh, 1989). However, the challenges and requirements associated with leadership roles have changed considerably in the 21st century organizational environment (Dess & Picken, 2000). For example, because of public outcry in the United States regarding actions of many corporate leaders, the U. S. Congress swiftly enacted the Sarbanes-Oxley Act into law in 2002; a decisive effort to confront what was clearly, a copious dose of

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organizational ethical dilemma. The Sarbanes-Oxley law imposes greater responsibility on corporate leaders and new reporting standard across public companies. Additionally, many organizations must now compete beyond their conventional geographical boundaries or comfort zones in order to survive. These are just a few of many new challenges facing new leaders in the 21st century.

More important, CEOs have become more visible and more powerful; hence, the stakes in the decision to buy or build the new CEO successor have increased (Lorsch & Khurana, 1999). The focus of this investigation align with the construct concerning CEO successor origins in relation to subsequent organizational financial outcomes; entails empirically reviewing all relevant organizational performance indicators such as return on equity (ROE), return on asset (ROA) or profit margin, and other related enterprise financial performance measurement indices.

Purpose of the Study

The main purpose for conducting this empirical research was to understand the relationship between new CEO successor origins and subsequent performance of *Fortune* 500 companies. Through quantitative research methodology, the researcher extracted and analyzed relevant empirical (longitudinal) evidence using financial performance measures. The findings help to determine the linkage between CEO successor origins and post-succession outcomes of *Fortune* 500 companies. The empirical evidence for this study came from financial data reported by *Fortune* 500 companies. Firms listed in the 2003 calendar year *Fortune* 500 companies that experienced single succession event during the period from 2003 through 2005 represented the final sample used in this study.

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The data analysis performed by the researcher resulted in findings, conclusions, and recommendations that are current and relevant. The results of this research on new CEO successor origins and subsequent organizational financial outcomes of *Fortune* 500 companies fill some of the research gaps as well as provide useful and current information for those leaders including board of directors who are involved in CEO successor selection decision.

Rationale

Given the considerable amount of studies on leadership over many decades, only a small fraction have reportedly directed at understanding more holistically the contingency theory or the relationship between CEO successor origins and subsequent firm financial outcomes (Humphreys, 2001). Additionally, advancements in information technologies have enhanced and simplified access to publicly available corporate data, allowing rigorous collection of relevant data than it was possible in the past. The research analyses results of this study should provide scientific evidence for corporate decision makers, enabling better understanding about the relationship between new CEO succession origins selection decision. Furthermore, the result of this study would allow forward-looking firms to able to understand the importance of successor origins relative to organizational performance and other implications associated with CEO successor type decisions.

Research Question

Specifically, this study seeks to determine whether financial performance of *Fortune* 500 companies differs depending on the new CEO successor origin. As such,

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there is one research question addressed in this study. The research question of this study follows:

Is there a relationship between new CEO successor origins and post-succession organizational financial outcomes?

The information gathered in this study should make valuable contributions to scholars and other researchers in organization and management studies as well as enhance and expand the current literature regarding the implications of the buy or build decision in selecting the new CEO successor.

Nature of the Study

This inquiry employs a non-experimental, relational quantitative research methodological approach (Robson, 2002) using publicly available archival data obtainable from various sources on *Fortune* 500 companies. This study extends previous research effort by empirically investigating the relationship between new CEO successor origins and post-succession firm financial outcomes of *Fortune* 500 companies. Because of the make-up of the *Fortune* 500 companies, data sampling from such representatives of firms should strengthen the reliability dimension as well as the generalizability of the research findings. More specifically, research findings in this investigation come from samples that would normally be suitable to answer the substantiative question postulated for this research. However, there are clear constraints on generalizability of the study findings across many firms to guide the buy or build decision in selecting a new CEO successor particularly in a diverse global market environment. Among many variables that make *Fortune* 500 companies suitable for this study, specifically include

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organizational characteristics such as: firm size, power structure, geographical location, sales volume/values, number of employees, industry type, board size and board composition, number of new CEO succession occurrences, and annual market and accounting returns, to name a few.

The research methodological approach employed in this study reflected both the nature of the research question guiding this study and the nature of primary research data sources. The empirical research data for this study are compilations of relevant public data from published and Web-based sources. This study is current with contemporary organizational milieu in that it used most recent and relevant financial data reported by pertinent *Fortune* 500 companies for the period starting from 2003 to 2007.

Significance of the Study and Conceptual Framework

The contemporary global environment has added a new dimension to the organizational leadership succession decision strategy. Now organizations must take into consideration possible consequences associated with the CEO successor's origin. Shen and Cannella (2002) argued that CEOs successor's origins "differ importantly with respect to their ability to manage change, their firm-specific knowledge, and the risk of adverse selection they pose" (p. 717).

Researchers have conducted numerous studies attempting to establish commonalities and predictable elements between CEO successor origins and firm outcomes. In many instances, CEO successions and organizational performance literature have evolved with little cross-fertilization, leading to more of the same in the debates. This study hopes to test some of the arguments, claims, albeit generally

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unsubstantiated speculations, even theories of the effects of successor origins. Analyses of pertinent empirical data collected from representatives of *Fortune* 500 companies provide objective performance measures and new information. The origin of a new CEO successor may have significant organizational financial implications (Zhang & Rajagopalan, 2003). Hence, this dissertation may fill a crucial gap in organizational and management literature by focusing solely on the relationship or linkage between CEO successor origins and post-succession organizational financial performance.

This study specifically capitalized on relevant information previously restricted by past technological constraints, particularly the contribution made by the advent of internet technology. The research conceptual framework presented in Figure 1 informs the construct of this research. Figure 1 presents two types of new CEO successor

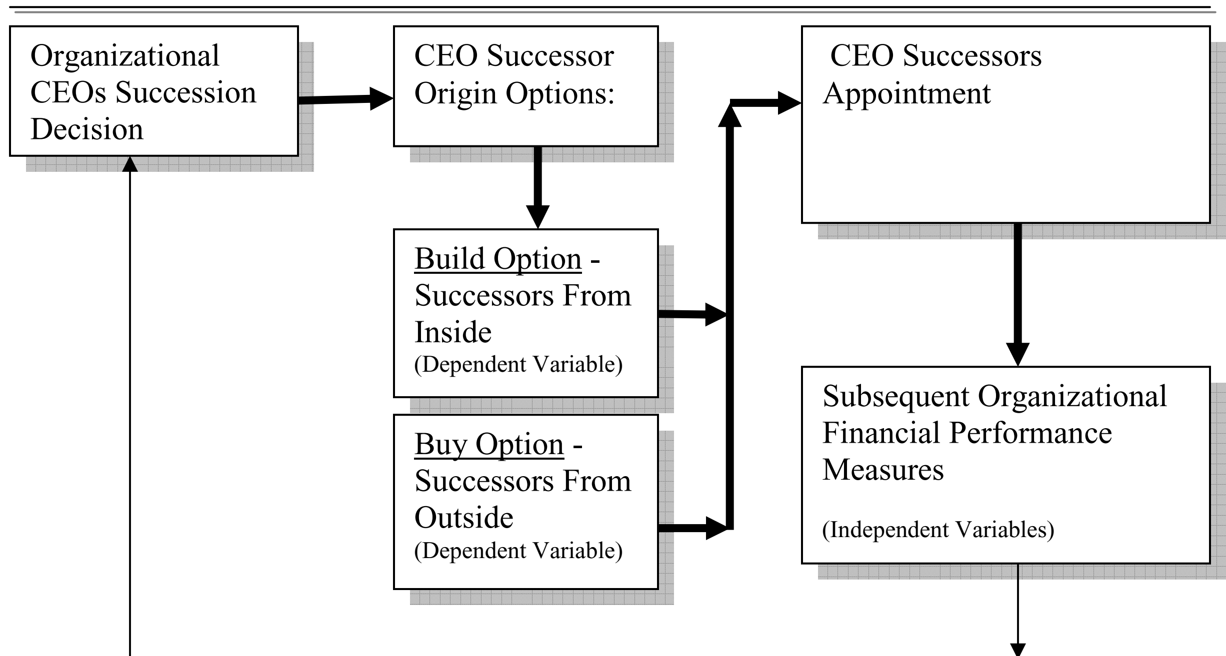

Figure 1. Conceptual Framework

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origin options including to *build* or to *buy*. The theory that each new CEO succession origin may affect subsequent or post-succession organizational financial performance was carefully discussed in the literature review chapter of this study.

The research data analysis that follows in other parts of this study further clarify many of the implications in post-succession firm financial performance between insider new CEO successors and outsider new CEO successors. The findings of this research represent valuable and up-close insight into some of the effects of new CEO successor origins selection decision.

This study should help to better understand some theories and predictable elements associated with CEO successor origins that could lead to favorable or unfavorable post-succession organizational outcomes. One of the fundamental premises of organizations is the recognition of a continuously dynamic environment; performance diversity among different individuals or CEO origins (Arbnor & Bjerke, 1997; Scott, 2003) most likely leads to varied firms outcomes. Some of the basic concepts driving this inquiry include organization theories, leadership theories, with emphasis on succession theories. This study evaluates utility of these theories relative to new CEO successor origins decision and subsequent firm financial outcomes.

The Research Hypothesis

This study test the following hypothesis:

Ho1. The selection of an insider CEO successor or an outsider CEO successor would results in no significantly different subsequent or post-succession organizational financial performance using critical Accounting-Based financial performance measures

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such as return on equity, return on assets, and leverage.

The study dependent variables are the CEO successor origin options: (a) Option to build or grow the CEO successor from inside the firm and (b) Option to buy CEO successor from the outside. The study independent variables comprised principally of Accounting-Based financial performance measures (e.g., return on equity, return on asset, financial leverage, plus many other applicable financial indicators) and other relevant non-financial performance measures.

Definition of Terms

The adoption of certain research terms is necessary to facilitate a unified discussion of the study topic. The following terms along with their contextual meanings apply to this study:

Accounting-Based and Market-Based indicators - Accounting-Based indicators reflect current organizational financial performance measures, which comprise of conventional financial post hoc indicators such as net profit, sales and rate of return on investment; some of the most prominent measures include return on assets, return on equity, and leverage. Market-Based indicators reflect investors' perceptions of organizational financial performance as measured by the stock prices (Cannella & Lubatkin, 1993; Dalton & Kesner, 1985; Shen & Cannella, 2002; Wiklund, 1999).

Build. Organizations often must develop or groom their future leaders internally.

Buy. Organizations often must recruit future leaders from outside the firm.

CEO. The title of the highest corporate leader (in some firms, it could mean any one of the following: CEO; president; chair; CEO/president; CEO/chair; president/chair).

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CEO succession. The process and/or methods that form the context of a CEO succession event in an organization (e.g., the replacement of the incumbent CEO) including the development of future CEO pipeline and executive recruitment practices (Gandossy & Verma, 2006).

CEO successor. A person designated or selected to replace the incumbent CEO.

CEO successor origin. A key CEO successor attribute which refers to whether a new CEO appointment is from inside (promoted within) the current organizational members (CEO-Type1) or recruited from outside the organization (CEO-Type2) (Shen & Cannella, 2002). CEO successor origins highlight the importance of succession context.

CEO succession planning. An establish process (formal or informal) by which future leaders are gradually develop or build to take the helm as the corporate CEO; or the design of explicit processes and policies for the development of future organizational leaders (Karaevli & Hall, 2003; Vancil, 1987).

Gross margin. Gross profits divided by current year sales. Gross margin is an important performance measure because it is size-neutral (Wiklund, 1999).

Leverage. The term leverage reflects the organization's ability to secure needed funds for its operations or a measure of the organization's debt utilization. Generally, when an organization increases its leverage, this may also translate to an increase return on stockholder equity; on the other hand, a higher leverage is also an indication of higher organizational financial obligations. Financial leverage calculation is organizational assets divided by the shareholder equity.

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Return on assets. Return on assets (ROA) is a measure of organizational profitability; it determines how company's assets (company debt plus shareholders' equity) are generating profits for the company or earnings generated from assets. The firms ROA measure is determine by dividing the firm's' operating income or net income (Compustat variable number: C#18 plus income taxes or C#4) by the firms' total assets (or C#8) for the same accounting period (Kesner & Dalton, 1994). A better than average ROA measure may indicate that the firm is employing its assets efficiently; the use of a pre-tax profit is intended to emphasize short-term efficiency qualities of this measure.

Return construct. Return construct is a measure of firm profitability as compared to the related industry benchmark or adjusted ROE; e.g., a firm's ROE adjusted by industry's average ROE may reflects the implication of new CEO succession origin (Cannella & Lubatkin, 1993).

Return on equity. Return on equity (ROE) is generally consider an effective measure of overall company efficiency by combining the following key financial measures including net income divided by revenues, which measures profit margin; and revenues divided by assets, which measures firms' asset turnover (Zajac, 1990). In summation, ROE comprises of a company's operating income or net income (C#18) divided by its average shareholder equity (common equity) (C#60) plus preferred stock (C#130) for a given same period. Shareholder equity represents assets created through retained earnings and paid-in capital (common stock outstanding, capital surplus, retained earnings, plus the net number of preferred stock at year-end multiply by value per share stated in firm's balance sheet) less same company total liabilities.

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Risk construct. Risk construct refers to variability in firm cash flow or financial returns due to firm-specific disturbances related to new CEO succession; e.g. low levels of return or low levels of cash flow could mean or construe as unsatisfactory outcomes related to new CEO succession origin (Cannella & Lubatkin, 1993).

Assumptions and Limitations

The term 'subsequent' or 'post-succession' means that this study is specifically limited to organizational financial performance data reported by pertinent *Fortune* 500 companies for a period not more than two consecutive years following a CEO succession event.

Most prior performance measurement period reported in CEO succession literature ranges from one year to three years (e.g., Boeker, 1992; Brockmann, Hoffman, & Dawley, 2006; Cannella & Lubatkin, 1993; Dalton & Kesner, 1985; Datta & Guthrie, 1994; Friedman & Singh,1989; Puffer & Weintrop, 1991). Hence, the use of a two-year performance period in this study is consistent with prior new CEO succession research (e.g., Boeker, 1992; Brockmann et al., 2006; Cannella & Lubatkin, 1993).

Relevant empirical research evidence is limited to financial and non-financial data of firms listed in 2003 *Fortune* 500 companies that experienced a CEO succession event during the years 2003 to 2005, and included in final research samples. As in most quantitative scholarly studies, findings of this investigation may not be generalizable outside of the *Fortune* 500 companies. In addition, it is beyond the scope of this study to address all organizational changes resulting from new CEO succession events within firms included in this research.

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The primary population for this study includes only U.S. firms listed in the calendar year 2003 *Fortune* 500 companies. Samples are drawn using purposive sampling procedure; the initial sample comprise of *Fortune* 500 companies (originally listed in year 2003 *Fortune* 500 companies) that experienced a CEO succession event between years 2003 and 2005.

Although there are two prevalent performance measures, to capture the central construct of interest, this study specifically employed the Accounting-Based returns measures as the main predictor variables. The Accounting-Based measure in this study may fall into one of many predictor variable categories including: 1) profitability, 2) leverages, and 3) efficiency. The Market-Based measure was discussed briefly for comparison purposes. Prior new CEO succession researchers have successfully used Accounting-Based performance measures (e.g., Cannella & Lubatkin, 1993; Dalton & Kesner, 1985; Wiklund, 1999). The accounting return, which is a gage of current firms' financial performance, specifically measure firms' profitability using prevalent Accounting-Based indicators. Market returns specifically measure firms' overall growth performance based on condition of cash flows and stock prices using the Market-Based indicators. Clearly, the implications of new CEO successor selection decision on organizational profitability and/or stakeholders interests is very critical and should be addressed as such; hence in most cases relying on both accounting returns and market returns may be necessary and has been employed by prior CEO succession researchers (e.g., Cannella & Lubatkin, 1993; Dalton & Kesner, 1985). The Accounting-Based financial measures computation is consistent with generally accepted accounting

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principles (GAAP). In addition, this study is limited in scope to corporations that utilize the same array of financial measures included in this study.

This study employed multiple discriminant analysis and stepwise procedure to eliminate highly correlated financial ratios, the results and implications emerging from the use of such methodological approaches are only as valid as the study data. The use of these models not by any means resolve the apparent financial ratios violation of normality assumptions.

Summary of chapter one and Organization of the Remainder of the Study

This study examine and compare effects of two dichotomous dependent variables (insider versus outsider CEO successors) to determine the possible relationship to the financial performance of *Fortune* 500 companies. Chapter one provides general information about this study, including the need to conduct this research. Relevant literature findings, issues, and trends associated with the research topic discussed to establish the investigation framework. This chapter helps to assert researchability of the research topic and its relevancy in today's global market milieu. The direction of this research delineates and anticipates possible contribution to the literature.

Prior empirical studies pertaining to CEO successions are explored in chapter two; the review of current scholarly literature and theories provide valuable insight into the antecedents of CEO successor origins and post-succession organizational performance. The chapter also describes the succession planning processes, current practices, firm performance and effectiveness measurements.

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Chapter three describes the methodology employed to achieve the goal of this study, including the research design, population, sample, data collection, and analysis procedure.

Chapter four presented the results of this study; and chapter five provides general discussion, implications, and recommendations for future studies.

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CHAPTER 2. LITERATURE REVIEW

Introduction

A general overview of the CEO succession literature highlights how the buy or build decision in selecting CEO successors has influenced subsequent organizational financial performance. This chapter explores the most current and relevant aspects of the CEO succession literature, including some of the theories that have been promulgated to explain organizational executive succession and its financial performance consequences. The literature exploring the antecedents and firm financial performance consequences of the buy or build decision in selecting CEO successors has been extensive in recent years (Cannella & Lubatkin, 1993; Kesner & Sebora, 1994; Zhang & Rajagopalan, 2004); however, most of these research findings are inconclusive or in many cases contradictory and constrained by various sampling limitations. Goodstein & Boeker (1991) argued that executive succession is an adaptive mechanism for ensuring effective organizational change; therefore, the CEO successor's origin decision (insider versus outsider) is a strategic necessity to ensure organizational adaptive advantage at exploiting environmental opportunities. This chapter includes organizational change theories, an overview of CEO succession, and financial performance. The summary section assembles key points and issues addressed in chapter two, and further explicate the rationale for undertaking this research.

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Organization Theories

The rational-adaptive theory (which suggests that change occurs in response to varied corporate demands) specifically supports the elasticity components of executive succession for achieving the desired organizational effectiveness (Cannella & Lubatkin, 1993; Friedman & Singh, 1989). The convergence of demands imposed by stakeholders for improved management practices/greater organizational financial performances and the demands imposed by the external/sociopolitical and new global market environments (Friedman & Singh, 1989), compel organizations to be very diligent when making the buy or build decision in selecting new CEO successors. Bodies of knowledge that provide clues on the effects of insider/outsider new CEO succession decisions are drawn from relevant literature; many of these studies explored the antecedents of CEO successor origins and inform on post-succession organizational financial performance implications.

The rational-adaptive proponents argued that organizations must continuously adapt to their various environmental conditions and demands to survive or achieve prosperity (Cannella & Lubatkin, 1993; Friedman & Singh, 1989; Goodstein & Boeker, 1991). This theory is an extension of the resource dependency view of the firm, which stipulates that successful organizations are those that can effectively adapt, change, and explore opportunities in their environments (Bommer & Ellstrand, 1996; Friedman & Singh, 1989).

The adaptive theory argument as supported by various empirical new CEO succession research findings, suggested that new CEO successors could improve post-succession firm financial performance (Hotchkiss, 1995; Husona, Malatesta, & Parrinoc,

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2004). A number of researchers have articulated similar research findings that suggest linkage between firm performance and new CEO successor appointments (e.g., Fredrickson, Hambrick, & Baumrin, 1988; Husona et al., 2004; Khorana, 2001; Rowe & Davidson, 2000).

The correlations between new CEO successions and organizational performance have been subject of debates and have generally corroborated by many scholars and other researchers. For example, studies by researchers such as: Allen, Panian, and Lotz (1979), Beatty and Zajac (1987), Boeker (1992), Brown (1982), Cannella and Lubatkin (1993), Furtado and Karan (1990), Puffer and Weintrop (1991), Tushman, Virany, and Romanelli (1985), and many others have shown that poor firm performance most likely results in new CEO succession. Researchers also investigated the effects of CEO successions on stock prices and the effects of CEO successions on firms themselves (Beatty & Zajac, 1987; Reinganum, 1985). For example, in a longitudinal study of 36 firms, Miller (1993) examines what happened to the organizational structure after new CEO succession; he found that new CEO succession "tended to be followed by a diffusion of authority" (p. 644). Some researchers have found that CEO dismissal is very prevalent when firm performance was poor (Boeker & Goodstein, 1993; Daily & Johnson, 1997; Harrison et al., 1988; Ocasio, 1994; Worrell & Davidson, 1987). Bommer and Ellstrand (1996) argued that "When corporate performance is perceived as unacceptable, directors frequently respond by replacing the most visible corporate leader—the chief executive officer, or CEO" (p.105)

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Overview of CEO Successions

Leadership succession has been a common practice in the religious and political arena since early civilizations. Weber (1947), a prominent sociologist/scientist, was among early organizational researchers to popularize leadership succession theory. Weber's work helped to propagate the leadership succession theory from events commonly associated with religious and political leaderships to become an important management and sociological phenomenon.

Research work relevant to organizational leadership succession has evolved gradually over the years, from primarily normative form to a much more substantial empirically based knowledge. In today's exceedingly complex and globally oriented organizational market environment, many implications associated with leadership successions, particularly a new CEO successor origin remain an important subject of discussions among scholars and practitioners (Boeker & Goodstein, 1993; Dess & Keats, 1987; Wasserman, 2003; Zajac & Westphal, 1996; Zhang & Rajagopalan, 2004).

Many have viewed new CEO succession events as capable of critically enhancing or diminishing the strategic posture of firms; more particularly, this single event can significantly affect performance outcomes of firms (Boeker & Goodstein, 1993; Vancil, 1987). Beatty and Zajac (1987) argued that the instabilities and tensions associated with new CEO succession event generally could precipitate a short-term decline in firm performance and the overall value of the firm. Many organizations are likely to experience some of the effects of new CEO succession phenomenon several times in their lifetime. The passage of top executive power or changing of the guard in the organization is a very significant event and has been recognized and acknowledged as

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such over the years (Brockmann, Hoffman, & Dawley, 2006). The effects of new CEO succession events on organizational prosperity has attracted considerable attention and continues to draw interests among organizational scholars and other researchers (Allen et al., 1979,; Cannella & Lubatkin, 1993; Harrison et al., 1988; Haveman, Russo, & Meyer, 2001; Lauterbach, Vu, & Weisberg, 1999; Zajac & Westphal, 1996; Zajac 1990; Zhang & Rajagopalan, 2004). Wasserman (2003) agues that the "CEO of an organization is a critical factor in its direction and performance; as a result, changes in CEOs or CEO succession events, are critical junctures for organizations" (p.149).

Literature review on CEO succession suggests that different firms react differently to similar performance and environmental information or sociopolitical issues; in other words, CEO succession events could mean different things to different organizations. One firm may view CEO succession events as mechanisms for responding to impending organizational crisis and other sociopolitical demands or conditions. Other firms may view it as the perfect mechanism for coping and adapting to changing global environmental conditions. It may serve others well as a means to break the existing status quo and send reform messages to re-energize dissatisfy stakeholders. Many others have viewed this phenomenon simply as a necessary event in the life of organizations (Allen, Panian, & Lotz, 1979; Grusky, 1963; James & Soref, 1981; Salancik & Pfeffer, 1980). Scott (2003) contends that under the contingency theory, "The best way to organize depends on the nature of the environment to which the organization relates" (p. 96).

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New CEO successor performance expectations may somewhat be affected by some other phenomenon besides CEO origins, including current global market economy, current competition, current industry structure, and many other sociopolitical factors that are ever present in the organizational milieu (Datta & Rajagopalan, 1998). However, most of these other influencing factors should have about the same effects whether the new CEO successor is selected from the inside the firm or from outside the firm.

Succession Theory

According to Furtado and Karan (1990), CEO succession literature generally conforms to one of three common research theoretical perspectives. The three CEO succession research perspectives together form the premise on which many variations in prior CEO succession studies have revolved. The first research perspective addresses *causes of CEO succession* (e.g. Dalton & Kesner, 1985; Fredrickson, Hambrick, & Baumrin, 1988; Grusky, 1961; Puffer & Weintrop, 1991). The second research perspective addresses *consequences of CEO succession* (e.g. Helmich & Brown, 1972; Pfeffer & Davis-Blake, 1986; Smith, Carson, & Alexander, 1984). The third research perspective addresses *shareholder wealth effects of CEO succession* (e.g. Friedman & Singh, 1989; Lubatkin et al., 1989; Reinganum, 1985).

Causess

Causes of CEO succession is a key research perspective postulated by many contemporary CEO succession researchers. This perspective focuses on antecedent conditions or the dramatic events (intertemporal events), changes that occurred within the organizational domain that lead to new CEO succession (Wasserman, 2003). For

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example, changes in the contingencies confronted by firms, anticipated and/or unanticipated changes in the organizational environment or sociopolitical conditions (Cannella & Lubatkin, 1993; Friedman & Singh, 1989; Lubatkin et al., 1989; Wasserman, 2003). Consistent with the adaptive or rational views, new CEO successor decision is an adaptive response to certain conditions or stimulus/factors in the organizational environment; e.g., performance related factors; congruency or fit factors; other voluntary or involuntary events in the organization (Cannella & Lubatkin, 1993; Friedman & Singh, 1989; Lubatkin et al., 1989). For example, poor organizational financial performance may not only causes new CEO succession event, it may also increase the likelihood of an outsider CEO successor (Cannella & Lubatkin, 1993). Many organizational scholars and management researchers like Dalton and Kesner (1985), Fredrickson, Hambrick, and Baumrin (1988), Grusky (1961), Puffer and Weintrop (1991) all have concluded that new CEO successor selection decision always preceded by antecedent conditions.

Consequences

This dissertation builds on and extends the research perspective postulated by Helmich and Brown, (1972), Pfeffer and Davis-Blake, (1986), Smith, Carson, and Alexander, (1984) among others. The majority of their research work focused on the theory of firms' post-succession performance consequences of new CEO succession origins. Most importantly, their research findings show that new CEO successor origin is not only among key contingency factors that can influence firms' performance and economic prosperity, it is also an important source of competitive advantage with the

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right new CEO successor selection decision (Howell & Higgins, 1990; Tushman & O'Reilly, 2002).

Most prior literature findings on research addressing performance consequences of new CEO successions primarily aligned with one of three dominant arguments and at times contradictory empirical dispositions. Advancements in these three arguments help to explain the effects of new CEO succession origins and subsequent organizational performance (Cannella & Lubatkin, 1993; Helmich, 1977; Pfeffer & Salancik, 1978).

The first argument, which is also the most commonly stated argument in the CEO succession literature, suggested a favorable connection between new CEO successions and organizational financial performance (Cannella & Lubatkin, 1993). For example, corporate board of directors frequently responds to unfavorable firm financial performance by simply replacing the incumbent CEO (Cannella & Lubatkin, 1993; Goodstein & Boeker, 1991). In other words, new CEO succession often construed as a rational adaptive mechanism for ensuring organizational financial success (Goodstein & Boeker, 1991). The second commonly stated argument is that new CEO succession has minimal or no meaningful effect on subsequent firm performance (Helmich, 1977; Pfeffer & Salancik, 1978). The contention of this second argument is that new CEO selection is inconsequential to the organizational survival or success, rather, that organizational success based on deterministic environmental forces (Hannan & Freeman, 1984). The third commonly stated argument claims that CEO succession is a disruptive and a ritual scapegoating event that is likely to generate unfavorable firm performance outcomes (Grusky, 1963; Helmich, 1977; Pfeffer & Salancik, 1978).

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Shareholder Wealth-Effects

Friedman and Singh (1989), Lubatkin et al., (1989), Reinganum (1985), and others added the third research perspective that addressed implications of new CEO selection on shareholder values. Research among contemporary scholars such as Samuelson, Galbraith, and McGuire (1985) compared relevant financial performance data of 122 firms; also, Beatty and Zajac (1987) compared financial records of 209 firms. Their findings corroborate prevailing arguments that new CEO successors' risk taking abilities surpass many incumbent CEOs. These studies also report that in most cases new CEO successors are more effective in making complex investment decisions that add more economic value to the firm. While these studies confirm that new CEO's successor could add value to the organization's economic prosperity, they however, did not delineate any consequences particular to the organization's decision to appoint an insider or an outsider new CEO's successor.

The resource dependency theory suggests that poor performance commonly occurs in response to poor use of firm resources, which often lead to incumbent CEO's displacement, and selection of new CEO successors. Similarly, Cannella and Lubatkin (1993) research findings suggest that a firm's profitability level is an important predictor of incumbent CEO dismissal. Some researchers (e.g., Tushman & Romanelli, 1985; Weisbach, 1995) suggest that new CEO successors often reverse unpopular prior firm investment decisions. There is also evidence to suggest they are more effective in redirecting organization resources to improve firm performance outcomes. Based on the various research findings, new CEO successors are often more responsive to the resource

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dependency theory.

One of the most challenging aspects of the buy or build decision in selecting CEO's successor is the lack of consolidated empirical guidance. Reliable and unified empirical research findings could enhance the organizational decision making process for deciding on the most appropriate or most logical new CEO successor origins. Currently, the only one thing that is consistent in the literature on new CEO succession events is that there is no consensus on how successions affect firm performance.

While researchers have investigated successor types extensively for more than five decades, they have generally failed to offer consistent or unify support for any of the theoretical perspectives or more insight into the consequences of new CEO succession origins. Emerging research findings continue to be less than definitive; findings generally continue to align along three separate theoretical reporting streams (Shen & Cannella, 2002).

The first and most common stream of reporting is base on the theory that new CEO successors directly and positively influence organizational financial performance (e.g. Camuffo, 2003; Chapman, 2002; Lieberman & Montgomery, 1988; Miller, 1993; Pfeffer & Davis-Blake, 1986; Vancil, 1987). Researchers in this stream of reporting strongly disagree with the 'upper echelons theory', which suggests that firm performance resulted from the efforts of the entire firm (Hambrick & Mason, 1984). House and Baetz (1979) argued that CEOs are directly and significantly responsible for most measurable variations in organizational performance outcomes. Weiner and Mahoney (1981) echoed the argument, using data gathered from 193 manufacturing organizations over 19 years;

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they concluded that CEOs clearly account for most organizational performance variations.

The second most common stream of reporting is base on the theory that new CEO successors are risky propositions that can threaten the efficiency of established strategy, structure, and critical processes of firms (Gibbons, 1992; Tushman & Romanelli, 1985). Some stakeholders perceive the CEO succession event as a possible disruption to the firm's performance expectations (Lorsch & Khurana, 1999). While some researchers argued whether post-succession firm performance has influence from other internal and external factors, many on the other hand, contend that the most risky aspects of succession are whether the new CEO successor has the relative capability or background necessary for firms underlying environmental imperatives (Gibbons, 1992; Salancik & Pfeffer, 1980).

The final and third most common stream of reporting reflects on scholars and researchers who have taken a middle ground stance. These researchers argued that prior CEO succession studies were generally inconclusive and in most cases reflected findings attributable to sampling limitations (Bommer & Ellstrand, 1996; Kesner & Dalton, 1994).

Many new CEO successors, depending on origin, often may be required to adopt different organizational paradigms; similarly, organizational variables such as size, environment, form, technology, among others, are likely to impose different demands on new CEO successors, thus requiring new leader behaviors and strategic focus, again depending on the new CEO successor's origin (Masood, Dani, Burns, & Backhouse, 2006). Most post-succession related organizational changes (structure, strategy, process,

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culture, and people) and subsequently firms' financial performance outcomes depend considerably on the CEO successor origin (Tushman & Romanelli, 1985). New CEO succession origins may also spark mixed reactions from both inside and outside organizations, thus creating favorable or unfavorable market conditions, which may affect stakeholders' wealth and result in other firm financial implications (Gibbons, 1992; Groysberg et al., 2006; Tushman & Romanelli, 1985).

One key aspect regarding the new CEOs decision is the knowledge to make the correct successor choice. There are means and ways to make the right CEO succession decision, as echoed by Tushman, Virany, and Romanelli (1985), that generally require specific knowledge and information about potential CEO successor contenders. More particularly, certain information and knowledge about potential CEO successor contenders include their human competencies, strength, capabilities, nature, and weaknesses, which are very critical to making the right CEO successor selection decision. Information gathering on future CEO successor candidate has always been a very challenging process; often requiring the use of costly executive recruit companies, particularly in case involving an outsider candidate. May requires numerous interviews of potential candidates; including aligning each potential candidate's human capital (productive assets or human competencies) to the organization's strategic posture (Fulmer & Conger, 2004; Groysberg et al., 2006; Vancil, 1987; Zhang & Rajagopalan, 2003). A match or no-match determination is a critical quality assurance step to establish congruence or fit with organizational strategic posture (Groysberg et al., 2006; Zhang & Rajagopalan, 2003).

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Groysberg et al., (2006) emphasized the distinction between firm-specific knowledge (knowledge specific to one particular company that is not transferable to another company) and generic knowledge (knowledge that may or may not be transferable to other environments). This theory pertains to CEO successor candidates' knowledge portability, or basic competencies that new CEO candidates bring that may or may not be transferable or useful in a new organizational environment. Verification of new CEO successor candidates' knowledge portability is among important selection criteria in determining the risk factor associated with the strategic option for selecting an outsider or an insider CEO successor (Groysberg et al., 2006).

Typically, among U.S. firms, the person holding the CEO title is the top executive and the highest formal authority; except in a few cases where one person is chairperson and another is CEO, then the chairperson is the highest authority of the firm. Many contemporary scholars (Carpenter & Westphal, 2001; Charan, 1998; Westphal & Zajac, 1995) argued that the organizational board of directors is responsible for the management of the firm and the CEO as the top executive controls the organization. Thus, the CEO is responsible for the direction, performance, strategic preparation, and alignment of the organization with relevant systems, and changes that are occurring throughout firms' environments, including adapting the organization to other environmental jolts (Charan, 1998; Goodstein & Burke, 1991; Kosnik, 1987; Meyer, 1982; Wasserman, 2003). In other words, all elements in the organization (both human and capital) are subsumable under the general rubric of the CEO (Pfeffer & Salancik, 1978; Scott, 2003). Consequently, new CEO successors must demonstrate philosophical congruence with the

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organizational strategic direction, demonstrate unique ability to manage change and move the organization forward profitably with minimal interruptions (Charan et al., 2001; Dess & Picken, 2000; Jayne, 2003; Lubatkin et al., 1989; Pernick, 2001). Because CEOs are the principal architects of organizational strategy and changes to achieve stated goals, the stakeholders also hold them responsible for the financial performance of the organization.

Both scholars and other researchers have conducted extensive studies and presented varied arguments on the effect of CEO succession origin in the past several decades (e.g., Chapman, 2002; Dalton & Kesner, 1983; Dalton & Kesner, 1985; Datta & Rajagopalan, 1998; Friedman & Singh, 1989; Grusky, 1963; Kesner & Sebora, 1994; Pfeffer & Salancik, 1978; Wasserman, 2003). However, this topic has yet to be rigorously researched vis-à-vis post-succession financial performance using current empirical data across many organizations, e.g. *Fortune* 500 companies (Cannella & Lubatkin, 1993; Dalton & Kesner, 1985; Zhang & Rajagopalan, 2003). Particularly, no empirically based studies conducted in recent years that examined implications of an insider versus an outsider CEO successor and post-succession financial performance in *Fortune* 500 companies. The following section of the study examined relevant literature on insider versus outsider CEO successors and subsequent firm performance.

Insider vs. Outsider CEO Successions

Whether the New CEO successor is an insider or an outsider has significant implications not only for power dynamics within the organizational upper echelons, also in terms of congruency with the organizational strategic focus; most particularly how quickly firms can respond to current environmental demands (Naveen, 2006; Shen &

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Cannella, 2002). One of the many important duties of the board of directors and the incumbent CEO is to identify and select new CEO successor who is most congruent with the organizational strategic direction and could move the organization forward with minimal interruptions (Naveen, 2006). Hence, the origin of the CEO successor, or whether a new CEO is selected from inside versus outside the firm, is an important aspect of the new CEO selection decision (Shen & Cannella, 2002).

Undoubtedly, numerous internal and external factors could influence the new CEO successor selection decision. CEO succession literature identifies many such factors including expectations or desires of the board of directors, CEO succession antecedents, availability of candidates, stakeholders and/or market signals, current organizational power structure, and changing environmental contingencies, to name just a few (Friedman & Olk, 1995; Rhim, Peluchette, & Song, 2006). Another key component in the new CEO successor selection process is the ability to get the right information on available candidates (Tushman et al., 1985).

Many CEO succession researchers recognized CEO successor origin as important CEO succession characteristics, with critical post-succession organizational performance implications (e.g., Beatty & Zajac, 1987; Cannella & Lubatkin, 1993; Friedman & Singh, 1989; Shen & Cannella, 2002; Worrell & Davidson, 1987; Zajac, 1990). Some researchers contended that insider CEO successors are more congruent with current organizational strategies, have established followers and are likely to maintain constancy and stability (Rhim et al., 2006). Other researchers argued that while outsider CEO successors are less congruent with current organizational strategies, they are nevertheless

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more likely to move the organization rapidly away from status quo and embrace changes in the firm's environment (Shen & Cannella, 2002).

When a CEO departs the organization, there is not only a sudden loss of valuable knowledge, also there is a sudden loss of momentum at least in some organizational pursuits; the incumbent CEO's departure could also result in a level of uncertainty among stakeholders particularly, regarding future organizational financial outcomes (Beatty & Zajac, 1987; Dalton & Kesner, 1985). The uncertainty resulting from the incumbent CEO's departure could add further complexity to the buy or build decision in selecting CEO's successor. An important implicit objective of this study is to add credence to the recognition that where the CEO successors come from does matters in the contemporary firm environment (Wasserman, 2003). The focus of this study, however, is to inform on the relationship between new CEO successor origin and subsequent firm financial performance of *Fortune* 500 companies.

This section is devoted to the review of relevant CEO succession literature that explores the antecedents of insider versus outsider CEO successors and subsequent firm performance. Antecedents of CEO succession reflect sociopolitical contexts, including anticipated (e.g. expected CEO replacement due to retirement) and unanticipated (e.g. unexpected or forced incumbent CEO resignations) events or factors preceding and ultimately enhancing CEO succession (Rhim et al., 2006; Shen & Cannella, 2002). For example, lower or poorer organizational performance may increase the likelihood that CEO succession would occur (Cannella & Lubatkin, 1993; Gilson, 1989). These same events or factors should generally moderate the relationship between performance and

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succession by facilitating or enhancing the replacement of the incumbent CEO.

The notion concerning whether insiders make better CEOs than outsiders or vice versa (Chung et al., 1987) may be moderated by several factors, including but not limited to leadership characteristics or personalities, individual talents, organizational strategies, firm environments, and many other sociopolitical conditions (Dalton & Kesner, 1983; Pfeffer & Salancik, 1978). Nonetheless, given the criticality of the CEO position in the organization, clearly researchers must continue the quest to know more about insiders versus outsiders CEO successors; particularly their post-succession firm financial performance implications (Cannella & Lubatkin, 1993; Chung et al., 1987; Dalton & Kesner, 1985; Zhang & Rajagopalan, 2003).

Many prior studies on the linkage between new CEO successor and organizational performance have not only been impressive, they have also yielded valuable insights. However, in addition to continuous inconsistencies in research findings, there has been a significant limitation in the research focus; particularly, many prior studies tend to focus primarily on behavioral, functional, and CEO demographic characteristics (e.g. Barrow, 2001; Beatty & Zajac, 1987; Cannella & Lubatkin, 1993; Carey, 2000; Dalton & Kesner, 1983; Datta & Guthrie, 1994; Dess & Picken, 2000; Harrison et al., 1988). Some of the research findings suggest only moderate correlation between CEO characteristics and firm financial performance in certain firms; other researchers argued that the research results are particularly not generalizable across firms (Rajagopalan & Datta, 1996).

Given the various theoretical perspectives (e.g. adaptive or rational model; disruptive model; inconsequential model; and inertial model) adopted by various

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Researchers to inform on relationships between new CEO succession and organizational performance, these same dissimilar perspectives may help explain the conflicting empirical findings in succession studies (Bommer & Ellstrand, 1996). Encouragingly, a promising and growing number of scholars and other researchers in organization and management literature are leading the way in gradually informing on the relationship between CEO succession and organizational performance based on the distinction of insider versus outsider or CEO successor origins (Cannella & Lubatkin, 1993; Dalton & Kesner, 1983). Advancing on this approach should not only energize strong movement toward a unify research methodology, may also provide a common lens through which researchers can view and understand the linkage between firm performance and new CEO successor origins.

Theory postulated by many researchers and echoed by this study is that post-succession firm performance is contingent upon new CEO successor origins. In other words, where the new CEO successor comes from most likely would have different effects on subsequent firm financial performance (Shen & Cannella, 2002). The consensus among researchers is that successors from the inside tend to reflect commitment to status quo with lesser opportunity or desire to change organizational strategy; in other words, selection of an insider CEO successor usually represents a signal from the board of directors and/or the outgoing CEO to continue current firm strategic position (Cannella & Lubatkin, 1993). On the other hand, a successor from the outside generally represents the desire of the board of directors to change current organizational strategic focus (Helmich & Brown, 1972; Husona et al., 2004; Zajac, 1990). According

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to Cao, Maruping, and Takeuchi (2006), pre-succession sociopolitical and organizational context (antecedents) may be a contributory factor in the determination of where the new CEO successor should originate; for example, prior firm performance, management team turnover, nature of the incumbent CEO departure, and environmental conditions could affect new CEO successor selection decision.

Based on the extensive research conducted on the topic in the past several decades, CEO successor origins (insider effect vs. outsider effect) represent important and critical succession research variables that are of vital interest to both organizational researchers and practitioners (Cannella & Lubatkin, 1993; Dalton & Kesner, 1985).

There is substantial new interest in the current literature to understanding some of the implications (e.g., performance consequences; succession outcomes) associated with insider versus outsider CEO successor selection decision (Karaevli, 2007). This new interest is, to an extent, encouraged by the general recognition, as evidence in current organization and management literature, that "not all new CEO successors are the same" (Zajac & Westphal, 1996, p. 64).

There is more to learn about antecedents of CEO successor selection choices. While researchers have devised many new research paradigms to provide helpful frameworks for exploring the linkage between CEO successions, particularly CEO successor origins and post-succession firm performance (Pfeffer & Davis-Blake, 1986; Zajac & Westphal, 1996), there are still considerable ambiguities and many unresolved issues (Allen, Panian, & Lotz, 1979). Hence, the research effort continues unabated among organization and management scholars and other researchers to determine

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conclusively the performance consequences of the buy or build decision in selecting organizational CEO successors (Dalton & Kesner, 1985; Wasserman, 2003).

In accordance with the adaptive perspective, the buy decision in selecting new CEO successors may the result of several factors, including persistent poor organizational financial performance (Cannella & Lubatkin, 1993; Furtado & Karan, 1990; Schwartz & Menon, 1985; Weisbach, 1995; Worrell & Davidson, 1987). Conversely, organizations are more likely to appoint new CEO successors from inside the firm when their most current financial performance barometers have been favorable (Friedman & Singh, 1989). However, mere appointments of new CEO successors from inside or outside are of no consequences unless more effective and capable successors are appointed. Additionally, although organizational financial performance condition may suggest appointment of an insider or an outsider CEO, the final new CEO successor selection decision must consider other relevant factors (e.g., new global competitive condition may necessitate selection of an outsider candidate); more particularly, the issue of fit and/or congruency between the new CEO successor and organizational strategic direction must be given careful considerations.

Current global business environments have added considerable complexity to the functional requirements of today's organizational CEOs, and their selection criteria. There are many determining factors, which may play pivotal roles in the final decision to select insider or outsider new CEO successors. Each insider or outsider new CEO successor candidate brings useful generic knowledge and experience to the firm; each candidate also brings unique and critical knowledge and experience that may or may not

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align with current organizational strategic directions (See Figure 2). In many cases, there are as many risks in selecting an insider as in selecting an outsider new CEO successor.

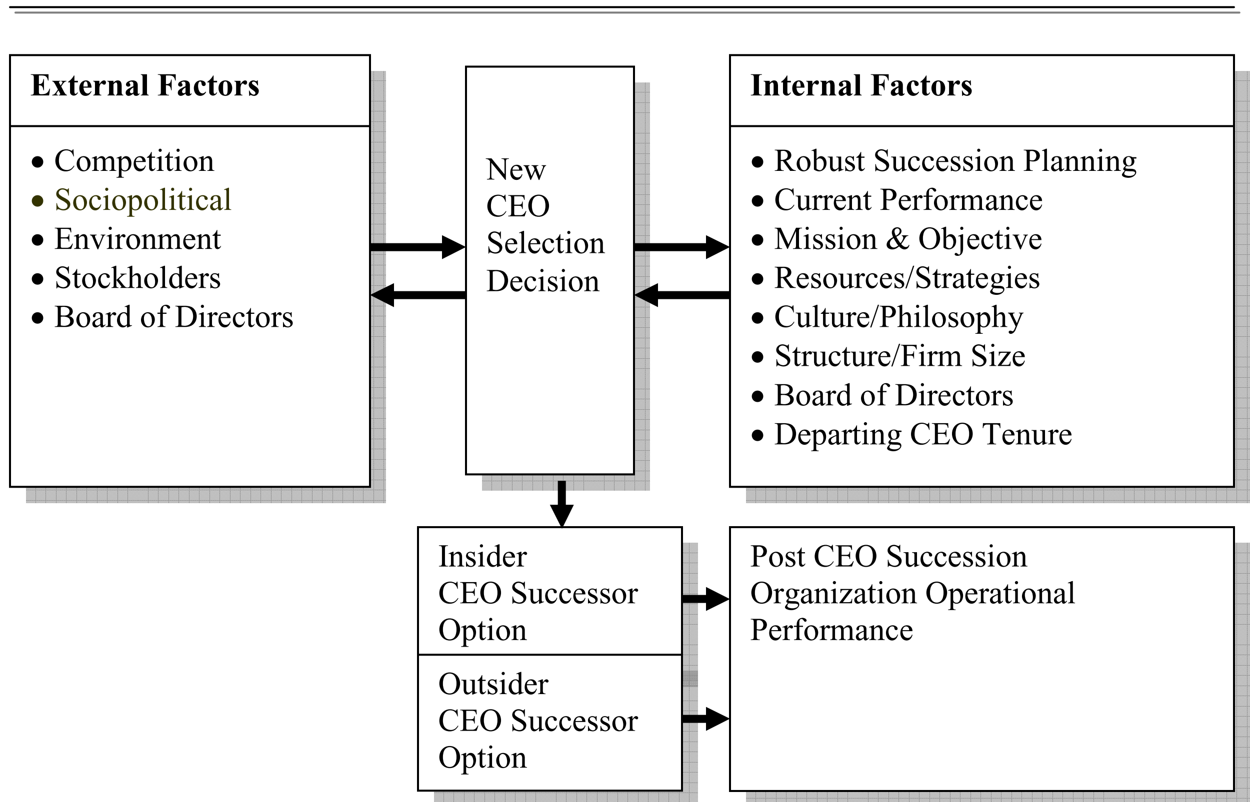

Figure 2. Factors Influencing Insider vs. Outsider New CEO Selection

selecting an outsider new CEO successor. The challenge is to be able to determine correctly, which particular candidate may bring more value to the firm to outweigh the perceived risks.

Because of changes in the global market milieu, insiders no longer have greater advantages over outsiders in spite of their connections to the firm's current strategic

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directions. In other words, there is no research evidence to support any notion that insider candidates provide added advantage in today's dynamic contemporary market place (Carey, 2000). Likewise, outsiders may possess a wealth of valuable experience, but there is no research evidence to support any areas of greater advantages (Carey, 2000). Thus, all contenders (insiders or outsiders) must be reviewed critically for their unique credentials; and most importantly, they must demonstrate congruency with organizational strategic posture in order to gain consideration and eventual selection as the new CEO successor (Chung et al., 1987).

Numerous studies have reported findings consistent with the adaptive argument that current firm financial performance significantly influences new CEO succession origin decisions (Cannella & Lubatkin, 1993). This research finding which has been consistently supported by other researchers; for example, Boeker and Goldstein (1993) reported that the CEO origin decision is influenced by the firms' desire to revise prior inferior firm performance, which often resulted in selection of outsider new CEO successors. Other conditions within firms have been suggested as contributory factors toward the selection of outsider CEO successors, including: size of the firm, structure, diversification, global market competitiveness, present of a copious ethical dilemma of incumbent leaders, and other sociopolitical conditions.

Research findings on executive hiring practices in recent years are continuously showing many highly respected *Fortune* 500 companies electing the option to buy rather than relying on internally groomed executive candidates to replace their incumbent CEOs (Pfeffer & Davis- Blake, 1986; Reinganum, 1985; Tushman & Romanelli, 1985).

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Among major Fortune 500 corporations that have made the decision to buy outside talents to replace incumbent CEOs include: AT&T, American Express, Boeing, Delta Airlines, Ford Motors, IBM, Motorola, just to name a few (Davidson, Nemec, Worrell, & Lin, 2002; Lashinsky, 2004; Marsh, 2006). Among critical supporting rationale for the buy decision in selecting CEO's successor is the added expectation that outsiders often bring different opportunities from organizational learning perspectives (Zhang & Rajagopalan, 2003); also, many of these corporations are ready for a new fulcrum to leverage organizational competitiveness in the new global market (Davidson et al., 2002). Clearly, there are compelling motives why firms may choose to buy their new CEO successor rather than to select a candidate from within the organization.

Given their independence from current organizational status quo, outsider new CEO successors are, generally perceived by stakeholders as change agents capable of instigating immediate value-added changes that can improve firms' financial state and enhance stockholders' wealth (Kesner & Sebora, 1994). This contention has been echoed in studies conducted by many researchers such as Cannella and Lubatkin (1993), Davidson et al. (2002), Husona, Malatesta, and Parrinoc (2004), and others. They found that many new CEOs selected from outside the firm have generated positive firm financial performance outcomes; in many cases, firm growth or shareholders' wealth (aka: Return-On-Equity or ROE) have shown increases at a much higher rate when firms have chosen the buy option in selecting CEO's successor.

Empirical evidence on stock price reactions following outsider CEOs appointments have shown significant positive stock market returns compared to insider

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CEOs appointments. For example, Davidson et al. (2002) examine the stock price data of Business Week's 1000 largest publicly listed U.S. corporations and their CEOs between 1982 and 1992 to study the stock market reaction to CEO successions announcements. They found that of the 421 CEO succession announcements during the period, the stock market reacts more positively to outsider successions. Kesner and Sebora (1994) echoed the study findings; they argued that the stock market has often reacted positively to outsider CEO successor appointments as a symbolic support of the organizations' buy decision in selecting CEO successors with fewer ties/loyalties to the status quo. Also, the excitement generated by bad incumbent CEO departure and the fresh perspectives that new outsider CEO successors can bring, coupled with favorable future financial performance expectations by stakeholders can produce a positive stock market reaction.

Vancil (1987) provides an interesting comparison of prevalent implications associated with new CEOs successor origins. Insider successors are generally view as mandate for continuity or measured strategic change; organizational response is generally a sigh of relief particularly when qualified candidate is available internally; and the new CEO agenda always entail team building and consolidation (Vancil, 1987). On the other hand, outsider successors are generally view as mandate for rapid change; organizational responses is generally a wait and see if conditions would be better or worse; and the new CEO agenda always entail strategic re-evaluation and restructuring (Vancil, 1987).

Many researchers argued that most troubled firms would most likely embrace the mandate that the outsiders bring to the organization. Generally, this means altering or changing current organizational strategic directions, reframing as much as possible from

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business as usual that produced current unfavorable firm conditions and bringing needed changes to improve performance (Chung et al., 1987; Dalton & Kesner, 1985; Vancil, 1987). Other researchers strongly believed that outsider CEO succession represents rapid adaptive response to organizational environmental changes Helmich (1974). Schuler and Jackson (1987) found that many growth-oriented firms with more outsiders in leadership positions outperformed other growth-oriented firms with more insiders in leadership positions. Friedman and Singh (1989) contend that "successors from outside tend to be seen as… torchbearers for changes in mission, strategy, and personnel (cf. Grusky, 1963; Guest, 1962; Lewin & Wolf, 1974)" (p. 726).

Friedman and Singh (1989) also argued, "Without entrenched loyalties to internal political coalitions, outsider CEO successors have relatively broad latitude to start afresh in matters concerning resource allocation" (p. 726). While current empirical evidence supports many aspects of the above contentions, some scholars and researchers have expressed concern that bringing in outsider CEO successors may disrupt or undermine the power structure of current organizational leaders, ultimately creating negative organizational consequences or decrease organizational effectiveness that could lead to costly short CEO succession tenure (Chung et al., 1987; Grusky, 1963). Considerable debates among scholars continue as to values and implications of selecting an outsider successor as opposed to selecting an insider successor and vice versa (Chung et al., 1987).

Although the empirical evidence continues to favor the argument that outsiders are more prone to change the status quo, and are more likely to provide a fresh

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perspective to the firm. Other organization and management scholars like Cannella and Lubatkin (1993), Shen and Cannella (2002), Wiersema (2002) all seem to support Grusky's (1963) 'vicious circle' argument that outsider CEOs may trigger a disruptive internal power struggle that could negatively affect subsequent firm financial performance. Cannella and Lubatkin (1993) argued, "Poor performance would lead to outsider selection only when sociopolitical forces are weak" (p. 763).

Other researchers have reported findings that suggest that post-succession firm performance was not significantly improved with outsider CEO successor origins (Dalton & Kesner, 1985). Many theorists like Ouchi (1982) on the other hand, argued that selection of insider CEO successors reflect well managed organizations and such organizations are also likely to have a robust succession process for developing their own leaders; and selection of outsiders may be seen as sign of troubled or poorly managed organizations. Compared to the outsider, many insider CEO successors are followers of the incumbent and are in many ways similar to the outgoing CEOs; they preserve many of the outgoing CEOs legacies and most likely support the current organizational vision (Zajac & Westphal, 1996). Depending on the exit condition of the incumbent CEOs, insider CEO successors have an unfettered access to the CEOs functionalities or on-the-job training before they assume the CEO position (Ocasio, 1999).

Usually, most insider CEO successors are protégés of outgoing CEOs; therefore, many may see insider CEO successors as instrumental to the continuation of current organizational strategies toward profitability. Kotter (1982), agues that, in many cases, insider CEO successors tend to be valued and presume to have more advantages over

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outsider CEO successors. Large firms such as GE, GM, and others, often rely more on inside executive talent (Dalton & Kesner, 1983). Insider successors also have the added advantage of firm-specific knowledge (e.g. familiarity with products, markets, milieu, technology, and customer). However, certain environmental and/or sociopolitical conditions (e.g. major regulatory changes) may render longer tenure or long-term organizational experience dysfunctional (Hambrick & Mason, 1984).

Organizational equilibrium theory suggests that the longer the tenure, the lesser the ability to generate innovative ideas when faced with challenging conditions (Helmich, 1977). Researchers such as Hambrick and Mason (1984) advanced this theory with their argument that "Executives who have spent their entire careers in one organization can be assumed to have relatively limited perspectives" (p. 200); and Wiersema and Bantel (1992), argued that long tenure was negatively correlated with firm strategic change. Miller (1991) and Ocasio (1999) have also presented research findings on CEO succession that are consistent with the same argument.

While literature review confirms confusions and inconsistencies in many current research findings, it also suggests the need to broaden succession research focus (larger sample, broader industry); this would further enhances understanding and better clarify the linkage between CEO successor origins and organizational financial outcomes (Shen & Cannella, 2002). This study hopes to help provides a more robust test of the relationship between firm financial performance and new CEO successor origins. The buy or build decision in selecting a new CEO is a very critical strategic decision; the final selection decision is also highly contingent upon which candidate is more congruent with

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the firms' strategic posture and sociopolitical conditions.

The next section explores the literature on the internal supply side of new CEO successor, specifically the *build* option. In order for organizations to be able to consider the 'build' option for new CEO successor selection, clearly must have a robust succession process for creating supply of internal candidates with characteristics that fit requirements for the CEO successor.

Succession Planning and Current Practices

Continuity or survivability of the organization over time depends on its capacity to maintain the current operation profitably and the ability to make sound predictions and decisions about the future. This also entails predicting the requirements and characteristics for an effective future CEO successor and establishing the necessary processes to assure that the most capable person would be taking the helm. Murphy (2006) argued that, "Succession planning has caught the attention of public and private sectors alike, as the demographic realities in the West pose daunting challenges" (p. 253). Organizations must continuously identify and update future strategic requirements and leadership characteristics of their top executives; take proactive steps to implement a succession process designed to meet future talent needs and when necessary, must recruit new top executives with skills or expertise that are more aligned with current and future organizational environmental conditions (Tuchman et al., 1985). Deegan (1986) suggests that a robust succession process is essential to organizational excellence. This study posits that organizational decision to select an insider or an outsider CEO successor is partly explained by whether the organization has a robust succession planning process

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and how well it has developed or prepared next-generation leaders.

With the new global market, current sociopolitical conditions, including the passage of the Sarbanes-Oxley Act of 2002, CEO succession planning has finally been elevated among top issues in the forefront of organizational strategic concerns (Biggs, 2004; Shen & Cannella, 2002). The board of directors and the incumbent CEO along with their cadre of supporting teams are key players responsible for establishing a benchmark process for identifying and developing potential candidates internally (Vancil, 1987). This robust succession planning process provides organizations the assurance of the 'built' option.

"There's nothing more important for the board of directors than to be sure that the company has the right CEO at all times" (Charan, 2001, p. 15). A well-designed and implemented CEO succession planning process would contribute greatly to successful new CEO succession decisions (Shaw, 2005). Additionally, a well-implemented CEO succession process would also become an important instrument for mitigating risks and disruptions associated with executive retirements, unexpected events such as death or departures, and including anticipated successions (Charan et al. 2001; Hall, 2006). Most importantly, a robust succession planning provides organizations with the alternative strategic option to build their own source of new CEO successors internally that are likely to be more congruent with the firms' strategic directions (Cannella & Lubatkin, 1993; Deegan, 1986; Friedman & Olk, 1995). CEO succession planning could also serves as a hedge toward the supply and demand for potential CEO successors. Moreover, the build or development aspect of the succession planning process provides an invaluable

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apprentice opportunity for future CEO successors, including increasing responsibility, risk, and reward opportunities (Deegan, 1986).

Clearly, the buy or build decision in selecting CEO's successor is predicated on the firm having developed a robust CEO succession planning process. Without a robust succession planning process, the new CEO successor's selection decision would be one dimensional with little or no assurances that the most qualified person was the selected candidate. Prior relevant research findings on CEO succession planning processes and practices reviewed delineate organizational strategic measures design to address CEO successor make or buy challenges, and inform on other contributing factors in the new CEO successor selection decision. Certainly, there are competing priorities and options in every business decision; however, a clear and robust succession planning strategy always ensures that the best new CEO successor selection decision is possible (Heath & Heath, 2007). Theoretical areas of review on to the topic of this study include leadership models or leadership styles, contingency and adaptive perspectives; each provides valuable insight and serves as viewing lenses to understand many aspects of CEO succession selection challenges, particularly CEO successor origins. While many extant CEO succession literatures provide different viewpoints and contradicting findings, collectively they form the theoretical foundation of what we currently know about the buy or build decision in selecting CEO's successor and subsequent firm performance.

Succession planning involves more than merely grooming replacement executives, it also informs outside interests about the health and functioning of the organization. In most cases, it can send signals about the presence of talent and

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well-developed executives internally that would be available and ready to meet future succession challenges (Rothwell, 2005). Research evidence confirm the contention that firms with robust succession planning and potential successor candidates tend to perform better than those without it (Rothwell, 2005). Succession planning process characteristics are more consistent with the organizational contextual conditions or organizational demographics (e.g. size, industry, culture, board composition, and power structure) and power structure (e.g. CEO duality/plurality and diversification) (Davidson, Nemec, & Worrell, 2001). In other words, one design does not fit all; every firm is unique, hence each organization must carefully design a succession planning process that is unique to the organizational characteristics (Vancil, 1987).

Different firms, depending on philosophy, power structure, value system, or culture, have employed several succession-planning models. One of the most popular succession planning models embraced by many prominent firms like GM, GE, AT&T, and many others is the ‘surplus’ succession planning model (horse race). This model entails having as many people qualified to hold executive positions as there are executive positions available. In other words, firms that adopt this model seek to develop candidates that are more qualified or create a surplus of talent even at the risk of loosing some of them to other organizations. Another succession planning model (relay race) commonly employed by others firms requires giving the opportunity for the new CEO succession development to one candidate. This succession-planning model is not the same as handpicking a successor in order to continue a legacy, such as the case with the *crown prince* or *heir apparent*. This model generally allows for a healthy competition

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opportunity between both insiders and outsiders; therefore, no one, for certain, knows who the selected new CEO successor would be.

CEO succession planning process is not just about motions and mechanics, it must be robust; there must be substance, intensity, and candor in the process. Without a robust process, the result could be devastating to both the organization and the stakeholders (Charan, 2001). The process is intense and focused on the development of predefined skill-sets per the recommendation of the board of directors, incumbent CEOs and the supporting teams. Most common areas of development include management decision making skills and people skills required in dealing with firms' constituencies or stakeholders (Charan, 2001). CEO leadership development and succession planning strategies should always link directly to the overall organizational strategic intent (Jayne, 2003). Forward-thinking organizations understand that robust succession planning ensures continuation of the business with minimal interruptions; also provides an effective means of building talent from within and passing the leadership baton without missing a beat (Allman & Conchie, 2006; Manthey & Balhoff, 2002).

Leadership pipelines, specifically CEO successions, are always a hot topic of discussions not only in the corporate board rooms, also among leaders across the organization and among other organization members; particularly as the *baby boomers* average age in 2006 approaches 60 years (Allman & Conchie, 2006). There are real and urgent reasons for organizations to be concerned with having the right people at the right place at the right time doing what is require to be able to move the organization forward strategically with minimal interruptions (Charan et al., 2001; Rothwell, 2005).

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To be successful, the succession planning process must completely connected with the organizational strategic direction; the goal is not only to ascertain where the company is headed, it is equally important to ascertain who is best equipped to take it there (Jayne (2003). The entire successions strategies, whether it is *build* or *buy* options, must align with the organizations strategic intent (Charan et al., 2001; Jayne 2003; Pernick 2001). There are many proven succession planning best practices and approaches (Rothwell, 2005; Vancil, 1987); some of the best practices include top-down approach, market-driven approach, career planning approach, future focus, and problem solving focus. Although many of these approaches have produced limited empirically supported assurances for success, they remain the best means for generating internal new CEO successor development options (Dess & Picken, 2000; Groysberg et al., 2006; Humphreys, 2001; Vancil, 1987).

Many prominent U.S. corporations in several well-publicized cases, e.g., American Express, Apple, AT&T, GM, IBM, just to name a few, have fumbled badly at passing the touch. These organizations failed to put in place an effective succession planning process (Carey, 2000 Charan, 1998; Deegan, 1986)); a substantial inertia in the rules of corporate CEO succession that is consistent with forward-looking organizations (Ocasio, 1999). This has unfortunately, resulted in rocky leadership power transfer from the old guard to the new among many of these firms (Carey, 2000; Charan, 1998; Deegan, 1986).

A few notable major U.S. firms such as Coca-Cola, GE, and TRW have scored favorable marks for having a robust succession planning process in place (Charan, 1998;

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Vancil, 1987). However, no other contemporary leader has demonstrated more strongly the value of CEO succession planning or executive development like the legendary former GE CEO, Jack Welch (Charan, 1998; Vancil, 1987). GE's succession planning process and leadership development practices set the benchmark among major corporations in the U.S. and around the world for developing capable internal leadership candidates. Under Jack Welch's leadership, GE attained the recognition as the most fertile training grounds of executive talents. GE also branded as outsider CEO supplier, and as one of the prime sources of outside CEO candidates for many major corporations in the U.S. and around the world (Charan, 1998; Krames, 2003).

Given the global competitiveness of the 21st century organizations, this new environment may not be as forgiving for lack of vision as the case may have been in the 80s and in the 90s when many prominent corporations simply missed the mark on leadership succession planning. Organizations must embrace the succession planning process in order to mitigate the consequences of power transfer or CEO successions (Helmich, 1977).

Unless organizations internally develop a robust CEO succession planning process, they face the risk of having only one basic strategic replacement option for new CEO successors. Ouchi's (1982) theory Z suggests that well managed corporations are most likely to select an insider CEO successor. In other words, having a robust succession planning process in place is a good indicator of a well-managed organization (Ouchi, 1982). A robust succession planning process increases the probability of selecting an internally 'build' new CEO successor candidate who is ready to move the

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firm forward without interruption; it also increases the probability of selecting a candidate with the characteristics that match the requirements set by the context of the job and by the board of directors (Lubatkin et al., 1989). On the other hand, organizations without a robust succession planning process have deprived themselves the option of an internally nurtured CEO successor candidate.

The concept of succession planning is a more complex process for organizations today than it has been in the past (Carey, 2000). Many companies still maintain a rigidly narrow definition of succession planning; however, many have come to the realization that succession planning is a very critical step toward the buy or build decision in selecting new CEO successor (Carey, 2000). The literature provided numerous advantages for selecting an insider CEO successor e.g., to preserve an exceedingly strong internal culture or organization legacy, retention of leadership talents to sustain competitive advantage, maintain momentum, continuation of organizational strategic initiatives, just to name a few. In order for a successful insider CEO successor option to occur, there must be a robust succession planning process in place for developing future leaders internally (Deegan, 1986; Vancil, 1987). Bower (2007), explains, "The most successful CEOs, on the balance, are those who are developed inside the company…but manage to maintain an outside perspective" (p. 91).

Financial Performance and Effectiveness Measurements

The upper echelon theory postulates that leaders, or in this case CEOs do matter and have significant effect on the organizational financial performance (Hambrick & Mason, 1984). Therefore, the decision to appoint an insider or an outsider new CEO

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successor has broad leadership and organizational performance implications. Organizational financial performance is an important factor, and possibly one of the most important predictors or determinants of CEOs length of tenure, (Salancik & Pfeffer, 1980), and a major factor for appointing new CEO successors (Dalton & Kesner, 1985; Salancik & Pfeffer, 1980).

According to the agency theory, conflict can arise between the interest of the board of directors and the CEO mainly because their respective goals or interests often do not automatically coincide (Eisenhardt, 1989; Fama, 1980). While the board of directors focuses on shareholders, CEOs focus on the firm. Among key functionalities of the board of directors, therefore include: (a) increasing the value of shareholders' wealth by maximizing firm performance requirements and expectations; (b) ensuring that CEOs, as top agents in charge, are acting in the best interest of stakeholders by establishing specific performance expectations (Puffer & Weintrop, 1991). Stakeholders require assurance that their contributions in the form of financial capital, human capital, and social capital would generate excess returns (Davis, 2005).

Hicks and Gullett (1981) argued that the return on investment is the key criterion by which owners judge managers. Many prior studies on CEO successions support the contention that firm financial performance has been the most investigated predictor of whether new CEOs are selected from inside or from outside the organization (Beatty & Zajac, 1987; Hambrick & Mason, 1984; Pfeffer & Davis-Blake, 1986; Reinganum, 1985). The basic question among researchers is where ideally should the next new CEO successors come from, and what are the financial performance consequences? While the

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relationship between new CEO successor origins and organizational performance remains conceptually appealing, past studies provide very little or empirically inconsistent evidence to support the theory that new CEO successor origins have direct effects on corporate financial performance (Cannella & Lubatkin, 1993; Dalton & Kesner, 1985; Vancil, 1987; Wiersema, 1995; Zhang & Rajagopalan, 2003).

While some researchers have recognized the performance concept as the time test of any organizational strategic decision, many other researchers viewed performance from a broader perspective or simply as a subset of organizational effectiveness (Puffer &Weintrop, 1991). However, the debate continues not only on basic terminology and on definitions, more important on how best to measure organizational performance and particularly what criteria or expectations to which to benchmark performance (Puffer &Weintrop, 1991). The empirical inconsistency common with prior research findings may have originated from the way that the financial performance is defined, for example, most of "…the performance measures used failed to capture the central construct of interest" (Cannella & Lubatkin, 1993, p.773).

Although the quest to discover the most relevant organizational performance measure is a central goal, the dilemma on firms' performance measurement remains a debated issue; "…to date, researchers have not reached consensus about many of the factors that may influence performance" (Short et al., 2002, p. 364). Management scholars and other researchers have introduced various outcome-based financial performance indicators to assess CEO fulfillment of the economic goals of the firm, and to examine the linkage between new CEO successor origin and post-succession firm

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performance. Some commonly used quick performance measures, as a reflection of new CEO effectiveness include: an evaluation of how the firm's financial performance stacks-up against analysts' forecasts, management earnings forecasts, adjusted stock prices, and financial statement analysis.

Organizational performance is a multidimensional construct that has often measured in previous research using various combinations of indicators (e.g., Beatty & Zajac, 1987; Datta & Rajagopalan, 1998; Friedman & Singh, 1989; Karaevli, A., 2007; Ocasio, 1994; Shen & Cannella, 2002; Zajac, 1990). In their effort to capture CEOs' fulfillment of firms' financial performance requirements, researchers have successfully demonstrated two distinctive categories of measurements as reliable firm performance measures including Accounting-Based measures, and Market-Based measures (Cannella & Lubatkin, 1993; Daily & Johnson, 1977; Lubatkin et al., 1989; Weiner & Mahoney, 1981). While the Accounting-Based measures focus on the organizational operational performance, the Market-Based measures reveal future organizational performance potential (Daily, Certo, & Dalton, 2000).

Many researchers (e.g., Cannella & Lubatkin, 1993; Hayes & Wang, 2003) argued that in some cases, reliance on multiple organizational financial performance measures such as Accounting-Based and Market-Based might be important. Combination of these measures could provide added reliability and reduced the potential risk of not capturing important dimensions of the research construct. The following section reflects the literature on two fronts: (a) addresses the two most prevalent organizational financial performance measures including Accounting-Based financial performance measures and

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Market-Based financial performance measures; (b) reviews a wide range of leadership nature or characteristic and its viability relative to the broader concept of organizational effectiveness and the implications on new CEO successor selection decision.

Accounting-Based Performance Measures

The review of the literature on firms' operational performance measurement provides specific knowledge that supports Accounting-Based measures as useful in evaluating firms' financial performance changes and in accessing new CEOs' effectiveness. Many of extant empirical studies tend to employ Accounting-Based measures; and considered by many researchers as very useful for firms' financial analysis and prediction (Casey, 1980; Libby, 1975). Accounting-Based financial measures are financial ratios derived from accounting statements and are commonly evaluated within the context of the organizational environment or specific industry benchmark (Barber & Lyon, 1996). Financial ratios are useful performance barometers, which allow stakeholders to assess the fiscal condition, the financial health, or view key conditions affecting organizational operations (Casey, 1980; Libby, 1975). Financial ratios are generally benchmark to the related industry rate of return; therefore, all measures included in this study are industry-adjusted; each reflected the delta of the sample firms' reported values and the corresponding measures typical within Fortune 500 companies.

Common firm operational financial performance measures (Garrison, 1976) are generally align under three organizational performance measurement groups: (a) profitability measures, (b) leverage measures and (c) efficiency measures as depicted in Table 1. The numbers of financial ratios under each group are many; however, only the

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most prominent financial ratios are included in the listing.

Table 1. Sample of Common Categories of Firm Financial Performance Measures

Profitability:	Calculation
Return on assets (ROA) Return on equity Profit margin or ROR	Net income/Total assets Net income/Total liabilities Net income/Revenue or Sales
Leverage:	Calculation
Equity to revenue	Total assets - liabilities/Revenue
Efficiency:	Calculation
Total assets turnover	Revenue/Total assets

There are many reasons why financial ratios are appealing to researchers. (a) Public availability of financial data for publicly traded firms; (b) It is the most effective means available for measuring organizational financial performance in terms of profitability, growth in asset or debt, and efficiency; (c) Financial ratios provide effective means for comparing financial performance results within same industry or across many industries; (e) Finally, past studies have shown possible correlations between organizational leaders and organizational financial performance using financial ratios (Casey, 1980; Casey, 1983; Houghton, 1984; Libby, 1975).

Market-Based Performance Measures

The Market-Based firm performance measure compares firms' market performance or shareholder returns to firms in a similar market or industry. This measure

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as defined by the intercept in a regression equation of the firm's performance and similar industry returns based on the capital asset pricing model (Cannella & Lubatkin, 1993; Daily & Johnson, 1997). "While early studies focused on changes in earnings per share, recent studies tend to employ operating income as a performance measure" (Barber & Lyon, 1996, p. 361). The Accounting-Based measures of firm performance represented the primary method of measurement in this study.

Leadership Characteristic and New CEO Succession Performance

The plethora of definitions and the considerable spectrum of perspectives clearly reflect the complex nature of leadership; although leadership is not the primary focus of this study, nonetheless, leadership characteristics are important criteria for selecting new CEO successor.

To understand leadership from the performance context of succession, we must also understand the essential nature of leadership, and its relationships to the well-being of organizations in the new global economy (Horner, 1997). Strong leadership with weak management could undermine the performance of the firm; this is an important consideration among other relevant variables in the selection of the new CEO successor.

The CEO's successor selection is the consequence of the belief that organizational performance is attributable to the organizational leader (e.g., Boeker & Goodstein, 1991; Friedman & Singh, 1989; Gilson, 1989; Grusky, 1963; Pfeffer & Davis-Blake, 1986; Lubatkin et al., 1989; Virany, Tushman, & Romanelli, 1985). The leadership theory helps us to better comprehend why the replacement of a corporate CEO is both necessary and important in the new global market. "Successes in the new global economy depend

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on good leadership" (Ohmae, 2005, p. 34). CEO succession is an important event with risks, possibilities, and with greater consequences like no other leadership position in the corporation. As Brockmann et al., 2006 argued, "The successes and failures of individual CEOs often translate into the successes and failures of the firm" (p. 215). The following section reviewed and compared three most prominent leadership theoretical perspectives in the literature and their linkage with organizational performance including transformational leadership, transactional leadership, and charismatic leadership theories (Northouse, 2004).

Transformational leadership theory is a phenomenon that has received empirical support as both visionary and strategic leader, a social phenomenon that inspires organization members to be at their best of ability, thereby influencing organizational outcomes (Barbuto, 1997; Murphy, 2005; Northouse, 2004; Rainey, 1994; Walumbwa et al., 2004). Transformational leadership is associated with a multiplicity of positive work attitudes, which could affect organizational outcomes (Barbuto, 1997; Murphy, 2005; Northouse, 2004; Rainey, 1994; Walumbwa et al., 2004). As Horner (1997) argued, regarding transformational leadership, "There is no other single trait that can consistently be attributed for a great leader" (p. 270). Prior research has provided a modicum of support for the transformational leadership effectiveness assertion as promulgated in the contemporary literature (Barbuto, 1997; Humphreys, 2001; Murphy, 2005; Trofino 2000; Walumbwa et al., 2004; Yammarino & Dubinsky, 1994). The transformational leader is deem as an adaptive leader who "works more effectively in a rapidly changing environment by helping to make sense of the challenges confronted by both leaders and

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followers and then appropriately responding to those challenges" (Bass, Jung, Avolio, & Berson, 2003, p. 207). As such, the transformational leadership continuously engages with or influences the external environment and seeks new ways to keep the organization ahead or in line with the competition (Goodwin, Wofford & Whittington, 2001; Masood et al., 2006).

Transactional leadership theory on the other hand, is a combination of recognition-driven and expectation-driven relationship between the leader and the follower (Bass et al., 2003). The recognition-driven transactional leader exemplifies relationship base on 'implicit contract' or quid pro quo exchange with their follower (Bass et al., 2003). The transactional leadership pays very little attention to the individualized development of the organization members (Bass et al., 2003); also, transactional leaders are most likely to dislike the succession planning process. Transactional leaders focus instead on the dimension of established organizational goals based upon transaction contingent reinforcement (Bass et al., 2003; Goodwin, Wofford & Whittington, 2001; Masood et al., 2006).

Charismatic leadership theory, unlike most leaders, connects with organization members "through the power of personality" (Howatson-Jones, 2004, p. 21). Raelin (2003) argued, "The pleasing personality of charismatic leaders is their greatest gift" (p. 48). Charismatic leaders are visionary, task oriented, and relationship oriented (Barbuto, 1997; Bryant 2003; Cohen, Solomon, Maxfield, Pyszczynski, & Greenberg, 2004). With charismatic leaders, organization members generally can expect inspiration, empowerment, awe and adoration (Cohen et al., 2004; Raelin, 2003).

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A common drawback for the charismatic leadership is that a mission could become an obsession (Sellers & Puri, 1996). "Dark side can cause major business problems, may skew their vision of the future, or unadulterated ambition may cloud their judgment" (Tritten & Keithly, 1996, p. 83). Charismatic leaders, like transformational leaders, are dynamic and instrumentally effective leaders with egalitarian fortitude (Cohen et al., 2004; Jordan, 1998; Lowe & Galen, 1996; Yukl, 1999).

Transactional leaders are the ideal leaders for the 21st century; on the other hand, charismatic leaders are similar to transformational leaders in regards to the status quo and enabling creativity. It can be said that "charismatic leaders often create new organizations, while transformational leaders change existing organizations" (Masood et al., 2006, p. 943).

Transactional leaders generally prefer a stable environment, endorsing only administrative or procedural changes rather than organizational changes. In other words, transactional leadership is not a champion of change, and therefore most likely to support maintaining the status quo (Murphy, 2005). While there are needs for leaders like charismatic leaders to create new organizations, the new global market also required leaders that can adapt existing organizations to the new global market environment.

Analysis of leadership theories as they relate to key priorities provides an overview analysis of how each of the aforementioned leaders relates to key leadership priorities (Bryant 2003; Dess, Picken, & Lyon, 1999; Hogg, 2001; Lowe & Galen, 1996). Organizations and leaders go hand in hand just like ships and captains. If we think about it, leaders are to organizations what captains are to ships. The ship, with its mighty

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horsepower, must rely on the captain's navigational ability not only to travel the seas from point A to point B, but particularly, in coping with all the navigational complexities and environmental changes along the way.

Murphy (2005) suggested that, in most organizations, leaders are the catalyst for creating new innovative organizational paradigm. The idea of a new CEO supplying a new innovative organizational paradigm is consistent with the organizational requirement to take appropriate risks to re-energize the firm, to reconcile with its continuous changing environments, and to conform to contextual expectations of appropriate organizational forms to gain legitimacy and to grow and prosper (Greenwood & Hinings, 1996). The continuously changing/dynamic organizational environment requires an equally dynamic and transformational CEO successor. However, as Tracey and Hinkin (1998) suggested, it is informative to see how certain leader types continuously strive for transformational results, but are often frustrated in reaching their goals because of unpredictable external/internal problems or conditions.

The contingency perspectives postulate that new CEO successor choice points to the contention that certain characteristics of the organizations and certain characteristics of the new CEO successors affect or play a pivotal role in the post-succession performance of the organization (Brockmann et al., 2006). In other words, subsequent organizational outcomes following CEO successor selection are contingent upon or affected by, among others, the organization's internal and external environments, strategic posture, size, resource, human capital, specialization and the ability of the successor relative to the job requirements.

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Many have argued that organizational performance is among important antecedent of CEOs succession origin. Luthans and Stewart (1977) argued, "From the contingency model of the organization, it is apparent that organizational performance is a function of the interaction of subsystem variable sets" (p. 188). Likewise, organizational environment is also an important contingency factor in the determination of the choice of a new CEO; as Gupta (1988) argued, the organizational environment exerts a "direct contingency impact on the composition and characteristics of executive leadership" (p. 164).

Traditional adaptive theory clearly suggests there is a correlation between current organizational performance level and the likelihood that an outsider CEO successor appointment occurring (Cannella & Lubatkin, 1993). The responsibility of appointing a CEO successor ultimately rests upon the incumbent CEO and the board of directors based on current organizational performance, organizational environments, and the robustness of the firm's CEO succession planning process (Davidson et al., 2001; Rothwell, 2005; Vancil, 1987; Zajac, 1990).

Summary of Chapter 2

The literature reviewed provides evidence that prior CEO succession research has not only been inconclusive, several studies also suffer from sampling limitations and particularly, narrow research focus (e.g., small sample, single industry) (Bommer & Ellstrand, 1996). In order to survive in the new global economy, organizations must fully understand the inevitability of organizational leadership change, and particularly the types of implications associated with the buy or build decision in selecting new CEO successor.

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The various underpinning theoretical and conceptual constructs reviewed help grasp the importance and the implications of the subject of this study. The literature exposed various interconnecting variables (internal and external) relevant to the buy or build decision in selecting the new CEO successor including the requirement to develop a robust succession plan or the need to overcome the succession inertia. The answer to the ultimate question regarding who should be the next new CEO or where the next new CEO successor should be coming from, hinges on both internal and external environmental and sociopolitical factors, the organizational strategic direction, and most importantly, availability of the right candidate.

The agency theory not only help laid the foundation for studying performance, also provides justification for the establishment of CEO performance expectations. The apparent important role of the financial performance measurement as greatly magnified in empirical research, including the usefulness of Accounting-Based and Market-Based measures as means to verify CEO contributions were among literature reviewed. In addition to experiences and/or demographic differences, leadership or personality type can also affect the new CEO successor.

Literature on the topic of this study shows, as Allen et al., (1979) stated, “There is a clear need for an empirical analysis that can elucidate in a rigorous and systematic manner, the relationship between successor origin and organizational performance” (p. 167).

Chapter 3 outline the methodological approach employed to achieve the research topic objective. The research methodological approach represents generally acceptable

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means by which assumptions about reality can become meaningful (Arbnor & Bjerke, 1997); hence, the appropriateness of the research method is critical to the research process and research outcomes.

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CHAPTER 3. METHODOLOGY

Introduction

The ultimate goal of this dissertation is to create knowledge. This chapter outlined the methodological approach by which the researcher achieved the intended goal of this research: better understanding of the relationship between new CEO successor origins and subsequent organizational financial performance based on relevant performance measures. The study employed a quantitative research model, which encompasses collecting and presenting relevant (longitudinal) evidence on pertinent *Fortune* 500 companies to determine whether there is any relationship between CEO successor origins and subsequent organizational financial outcomes.

There are advantages and disadvantages associated with selecting new CEOs from the inside or from the outside of the organization. Grusky (1960) argued, “The universality of succession in formal organizations and the tendency of the process to promote instability combined to make this phenomenon of crucial importance to organizational theory” (p. 115).

The research question of this study is as follows:

Is there a relationship between the new CEO successor origins and subsequent or post-succession organizational financial outcomes? This research provided corroborative scientific evidence specifying the magnitude of relationship between new CEO successor

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origins and subsequent organizational financial outcomes.

The hypothesis tested in the research is as follows:

Ho1. The selection of an insider CEO successor or an outsider CEO successor would result in no significantly different subsequent or post-succession organizational financial performance using critical Accounting-Based financial performance measures including return on equity, return on assets, and leverage.

This study sought to gain better understanding of the new CEO succession phenomena (origins) through relational quantitative research approach using relevant (longitudinal) publicly available financial and non-financial data of pertinent *Fortune* 500 companies.

Research Design

The following section of this dissertation presents the research methodological approach and the specific research design employed by the researcher for gathering relevant financial as well as non-financial study data. This section specifically outlined the primary sources of the research data; it also described the methodological techniques for data analysis that follow in the subsequent chapter.

Consistent with the research problem for this inquiry, the study employed quantitative mode of inquiry using statistical procedure and hypothesis testing. The quantitative research method or positivist methodological approach, viewed by many as "the 'gold standard' for social research" (Robson, 2002, p. 4), has dominated many research studies, including doctoral dissertations and other published/unpublished papers. The quantitative approach exemplifies rigor, superior external validity, and profound

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means of generalizing findings (Simonton, 2003).

Quantitative research revolves around the ontological assumptions that organizational and social issues rely on creating knowledge in a rational and scientific manner through rigorous applications of statistics and mathematics (Cooper & Schindler, 2003; Mehmetoglu, 2004; Robson, 2002). In other words, the quantitative model "assumes that individual behavior is predictable" (Tashakkori & Teddlie, 2003, p. 67); it views reality and the world as a fixed social structure that researchers could discover or penetrate using scientific laws of statistics and mathematics (Arbnor & Bjerke, 1997; Robson, 2002). In short, the strategies of inquiry in quantitative research generally align with the post-positivist perspectives (Creswell, 2003).

Sample Design

The total population (N) for this research comprise of all U. S. companies listed in the Fortune Magazine's annual report of *Fortune* 500 companies for the year 2003. The *Fortune* 500 companies is a compilation of strong and highly regarded (with respect to their financial performance) publicly held U.S. corporations with a large cross-section of industries that spread across many geographical locations. Although these firms may not accurately represent entire business population, they account for substantial shares of total business activity as well as total population of U. S. firms (Stimpert & Duhaime, 1997). This is an important point of departure from most prior CEO succession studies, in which the equivocality of research findings possibly affected by limited population or bias stemming from limited sample sources and other sampling practices (Birley, 1984; Short, Ketchen, & Palmer, 2002).

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All firms in the initial sample selection for this study specifically met the following two requirements. (a) must be listed and CEOs identified in the year 2003 *Fortune* 500 companies; and (b) must have experienced a CEO succession event in the period between 2003 and 2005, as evidenced by changes in the identity of CEOs in the *Fortune* 500 companies during same period.

Purposive Sampling

"A well-drawn sample more effectively mirrors the population of interest, allowing relatively accurate generalization of relationships from the sample to the population" (Short et al., 2002, p. 364). This study employed non-probability purposive sampling technique to cull the initial study sample from the population of organizations listed in the calendar year 2003 *Fortune* 500 companies. The use of such non-probability sampling technique is prevalent among researchers; it was the sampling choice in nearly one-half of all strategic management studies between 1980 and 1999 (Short et al., 2002). In spite of its shortcomings (e.g., subjective in nature, lacks variance estimator, etcetera), purposive sampling procedure "…has been generally satisfactory" (Cooper & Schindler, 2003, p. 202). Purposive sampling technique is particularly efficient in two-segment populations since it focuses on the representative units; it is also convenient and the primary virtue is low cost in contrast to the popular probability sampling procedure employed in many quantitative studies (Aldrich, Kalleberg, Marsden, & Cassell, 1989; Cooper & Schindler, 2003; Kalleberg, Marsden, Aldrich, & Cassell, 1990).

In this study, probability sample from the total population (2003 *Fortune* 500 companies) could not work because many firms (e.g., companies that experienced no

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succession event during 2003-2005) would not be contributing any information. Hence, the use of purposive sampling allowed the research to focus on the segment of the study population with representative samples that best help to answer the research question. In other words, the use of purposive sampling also means that all non-contributory segments have zero probability of inclusion in samples.

Sample Determination

The initial study sample, using non-probability purposive procedure, comprised of firms listed in the 2003 *Fortune* 500 companies that experienced a new CEO succession event during the 2003 to 2005 period, as evidenced by changes in the identity of CEOs listed in the *Fortune* 500 companies during same period. For example, the total population of firms included in this study as listed in the 2003 *Fortune* 500, or $N = 500$. The initial sample (n) reflects those firms (listed in the 2003 *Fortune* 500 companies) that experienced a new CEO succession event during 2003 to 2005 period. All 2003 *Fortune* 500 companies (x) that have not experienced a new CEO succession event during the 2003 to 2005 period had zero (0) probability of inclusion in the final samples of this study. Additionally, this study excluded all firms with more than one succession event during the 2003 to 2005 period.

The following simple purposive-based mathematical equation reflects initial sample size determination for this research: $N - x = n$. In this case $N = 500$, both x and n can be determined from the actual records of the *Fortune* 500 companies between 2003 and 2005. Based on the assumption of *ceteris paribus*, inference from larger samples are more reliable than from small samples (Short et al., 2002). Hence, the sample size

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calculation for this study assumes that all firms listed in the 2003 *Fortune* 500 companies that experienced a CEO succession event in the period between 2003 and 2005 would be included in the initial study samples.

Measurement Design

The intent of this study is to provide timely and useful insights into the relationship between new CEO successor origins and post-succession firm financial performance of *Fortune* 500 companies. This study adopts the following three measurement design steps suggested by Barber and Lyon (1996): (a) select appropriate measure of operating performance; (b) employ the appropriate industry benchmarked; and (c) select an appropriate statistical test. The financial performance measurements encompass composite measure of changes between pre- and post-succession position of prominent organizational operational performance indicators resulting from new CEO origins (insider vs. outsider) selection decision. Specifically, measurement efforts entailed comparative analysis of financial and non-financial data across representative samples of *Fortune* 500 companies to obtain valuable insights on the topic of this study.

The performance measurement period reported in the CEO succession literature ranges from one year to three years (e.g., Boeker, 1992; Brockmann, Hoffman, & Dawley, 2006; Cannella & Lubatkin, 1993; Dalton & Kesner, 1985; Datta & Guthrie, 1994; Friedman & Singh, 1989; Puffer & Weintrop, 1991). Cannella and Lubatkin (1993) argued, regarding the CEOs' tenure, that CEO successors with less than two years of service would relatively be considered as new or outsiders. After two years of service, CEO origins should have very little if any influence on the firm performance.

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The two-year period allows enough time to assess the efficacy of new CEO successors' performance (Brockmann et al., 2006). Using no more than two years of post-succession financial data, makes this study consistent with prior new CEO succession studies (e.g., Boeker, 1992; Brockmann et al., 2006; Cannella & Lubatkin, 1993).

Measurement of relevant return parameters is a key criterion by which stakeholders can judge the performance of firms, as well as determine the effectiveness of new CEO successors (Hicks & Gullett, 1981). Many extant organizational studies have provided evidence that financial ratios, particularly Accounting-Based financial measures such as return-on-equity, return-on-assets, and financial leverage, are useful and relevant measures of firm performance and are good measures of new CEO successor effectiveness (Houghton & Woodliff, 1987).

Accounting-Based financial measures are particularly appropriate in this study inasmuch as prior researchers have frequently employed the same parameters to assess organizational financial health relating particularly to post-CEO succession firm performance (Beatty & Zajac, 1987; Datta & Rajagopalan, 1998; Ocasio, 1994; Shen & Cannella, 2002; Zajac, 1990).

While the usefulness or popularity of Accounting-Based financial ratios is noteworthy, how effective are these financial ratios in terms of statistical analytic device? This research turns to prior studies for clues. Clearly, "an intelligent analysis of the [financial] ratios can provide insight to a firm's economic characteristics and competitive strategies" (White, Sondhi & Fried, 1994, p. 199); however, there are issues that may influence validity and reliability of financial ratios. For example, Gombola and Ketz

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(1983) argued that specific financial ratios differ in their consistency of measure among different firms. The recent surge in globalizations, complex diversifications, and vertical integrations or as Barnes (1987) noted, “industry-wide factors” (p. 450), make compilations of financial data into specific industry averages more complex, and could potentially undermine the reliability of traditional financial ratios.

The effect of most industry-wide factors is minimal at best and could be resolved or neutralized using appropriate industry averages and benchmarks. The more important issue affecting financial ratios as a viable analytical tool is concerns with the apparent violation of normality assumptions. The issue regarding non-normality of financial ratios is very critical to the reliability of the research outcomes and raises the question regarding the effectiveness of financial ratios as a statistical analytic device.

Empirical researchers have found that financial ratios by nature have implications of non-normally distributed with apparent domination of inconsistent random pattern, skewness, and collinearity. In other words, financial ratios violate basic statistical normality assumptions; hence, they are not likely to be efficient for analytical use and are likely to misinform or lead to faulty conclusions (Barnes, 1982; Casey, 1980; Deakin, 1972; Houghton, 1984; Libby, 1975). Researchers generally accepted that because “…financial ratios are highly correlated, the resulting coefficient …may be very unstable and thus of little value in determining the relative importance of the individual variables included in the [analytic] model” (Mapp, 2007, p152).

To address the issue regarding non-normality of financial ratios, many researchers have examined, used, or suggested various statistical techniques that could eliminate,

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transform or reduce the problem of highly correlated financial ratios or research data (e.g., Altman, 1968; Barnes, 1982; Dambolena & Khoury, 1980; Deakin, 1972; Joy & Tollefson, 1975; Libby, 1975). Clearly, normality of the research data is a prerequisite assumption for an informed statistical relationship (Barnes, 1982; Deakin, 1972). This study employed available statistical methods that are prominent among researchers for mining or conducting outliers and transforming non-normal financial ratios to become approximately normal distributed data.

Through analytical contributions of many researchers, financial ratios (even with inherent limitations) continue to be a fundamental tool for conducting financial statement analysis. For example, the pioneering effort of Altman (1968) identified analytical steps by which the use of multivariate statistical techniques could help to transform or eliminate the violation of normality assumptions, thereby making financial ratios more suitable or reliable in studies requiring financial statistical analysis. Many rigorous statistical techniques suggested by different researchers are widely accepted for use (each with different levels of acceptance) in the resolution of non-normality of financial ratios including stepwise discriminant analyses, ratio stability, factor analyses, and the biased minimum Chi-square rule among others.

The research hypothesis posited that the buy or build decision in selecting a CEO successor would results in no significantly different post-succession organizational financial performance using Accounting-Based financial return measures. In other words, if the research findings showed that the buy or build decision in selecting a CEO successor had resulted in significantly different post-succession organizational financial

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performance (e.g., significantly different return on equity, assets, leverage, etc.), then such findings would be useful scientific evidence to assist organizational buy or build decision in selecting a new CEO successor. A note of caution: the evidence and theory from this study are based on year-2003 *Fortune* 500 firms with a new CEO succession event during years 2004 through 2005, using just a few prominent financial measures, therefore may not be generalizable to other none *Fortune* 500 companies.

This study specifically assessed the organizational operating performance following new CEO successor decisions using financial outcome measures (see Table 2). Dependent variables in this study are dichotomous in nature. In other words, new CEOs were categorized into one of two CEO successor origin including new CEO successors

Table 2. Commonly Employed Firm Financial Performance Measures

Financial Measures	Application of Measures
Long Term Liabilities Percent	Long Term Liabilities/Total Assets
Return on Assets (ROA)	Net Income / Total Assets
Cash Percent	Cash / Total Assets
Current Assets Percent	Current Assets / Total Assets
Current Liabilities Percent	Current Liabilities / Total Assets
Cash to Current Liabilities	Cash / Current Liabilities
Current Ratio	Current Assets / Cur. Liabilities
Cash to Revenue	Cash / Revenue
Receivables to Revenue	Current Receivables. / Revenue
Inventory Turnover	Cost of Goods Sold / Inventory
Current Assets Turnover	Revenue / Current Assets
Working Capital to Revenue	Cur. Assets – Cur. Liab. / Rev.
Fixed Assets to Revenue	Net Fixed assets / Revenue
Total Asset Turnover	Revenue / Total Assets
Equity to Revenue	(Total Assets-Total Liab.)/ Rev.
Revenue per Employee	Revenue / Number of Employees
Gross Margin Percent	(Revenue – COGS) / Revenue
Gross Margin RO Inventory	Gross Margin / Inventory
Return on Equity	Net Income / Total Liabilities
Revenue Growth	(Rev. CY- Rev. PY)/ Rev. PY

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selected from inside the firm (CEO-Type1) and CEO successors selected from outside the firm (CEO-Type2) based on the CEO successor event in firms selected in the study final samples. Independent variables in this study comprised of Accounting-Based financial measures (including those previously used by researchers) obtainable from the final study samples financial statement information (see Table 2) and applicable across firms for the study years 2003 through 2007.

Data Collection

This research employed publicly available secondary data from both published and Web-based sources. Relevant research data (financial and non-financial) on pertinent *Fortune* 500 firms was collected from the archival records for one-year prior and two-year following a new CEO succession event. The most used sources for archival records include Fortune magazine database of the *Fortune* 500 companies, COMPUSTAT, corporate 10-K, corporate library, Dun & Bradstreet Reference Book of Corporate Management, Standard & Poor's Register of Corporations, and any other relevant sources. The data collection method for this study is consistent with a non-experimental relational quantitative research methodological approach employed in prior new CEO succession studies (Robson, 2002; Zajac & Westphal, 1996).

The two categories of data collection employed (one-year of financial results prior to new CEO selection; and consecutive two-years of financial results following a new CEO selection), also represented the primary mode by which the research findings categorized. Hence, the two ranges of financial data collection periods in this study followed: (a) pre-succession year: 2003 or year 2004, (b) post-succession years: 2005 –

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2006, or 2006 - 2007. Relevant financial and non-financial data from the respective data period were then analyzed and compared to assess new CEO successor origins and firms' subsequent financial performance implications.

Some of the specific data collected for this study include but are not limited to the following variables. (a) New CEO successor origins (insider vs. outsider); (b) Demographic variables, including leadership and firm characteristics (firm size, number of employees, and others as applicable); (c) Financial ratios (e.g., return on assets, return on equity, ratio of assets to equity, and others as applicable). Other relevant financial data and non-financial data that could make substantial contribution to this study received appropriate considerations.

Data Analysis

Financial ratios generally represent the quotient derived from two accounting or financial statement data for the purpose of measuring or analyzing firm financial health. Most extant research on organizational performance uses financial ratio analysis as its foundation. This study employed relevant financial ratios that are available across *Fortune* 500 companies' final study samples. The study's data analysis process began by preparing the research data for measurement, which entailed coding and categorizing the study variables and selecting the appropriate statistical techniques and/or mathematical equations to test the study hypothesis in an effort to substantiate the research construct. This study employed the following coding scheme based on the year the CEO succession event occurred (see Table 3):

- Pre-succession year (Prior Year) = Yr-1

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- Succession event year = Yr0
- First post-succession year (Follow-on Year) = Yr+1
- Second post-succession year (Follow-on Year) = Yr+2

The following coding scheme applies to the CEO successor origins (the study dependent variables): insider CEOs = CEO-Type1 and outsider CEOs = CEO-Type2.

Table 3. CEO Succession Years Coding Scheme

Coding	Yr-1	Yr0	Yr+1	Yr+2
Years:	2003 (1)	2004 (2)	2005	2006
Years:		2005 (2)	2006	2007

Notes: (1) The study population (N=500) is based on firms that are originally listed in the 2003 Fortune 500 companies.
(2) First Fortune 500 companies' new CEO succession events for this study occurred in either 2004 or 2005.

Other quantitative data analyses steps (Creswell, 2003) in this study include reporting of any data anomalies, any known bias or biases that could affect the goodness of the study data or that could impair validity and the replicability of this study. A very critical final data analysis step entails making the choice of the appropriate statistical technique, including the rationale for selecting the particular statistical methodology.

The following section presents the statistical technique for development of the model in this study. Given there are a considerable number of statistical methodologies toward resolution of financial data violation of normality assumptions (Mapp, 2007), this study employed statistical methodology that has the distinct advantage over other analysis models.

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Upon careful consideration of available financial analysis models, the overall nature of this study, and the number of pertinent independent variables or financial ratios, this study employed the multivariate discriminant analysis (MDA) as the appropriate statistical methodology. There is substantial precedence to show discriminant analysis technique as statistically robust to analyze simultaneously an entire profile of characteristics and interactions among two or more variables (e.g., Altman, 1968; Klecka, 1980). Multivariate statistical technique "allows the researcher to study the difference between two or more groups [dependent variables]…with respect to several independent variables (financial ratios) simultaneously" (Klecka, 1980, p. 7). Specifically, MDA advances the capacity for calculating covariances between the study predictor variables and the distinct capacity for differentiating the most important independence variables.

Multicollinearity Issues

One area of concern, which is critical to the usefulness of MDA, is the effect of multicollinearity among financial ratios. Multicollinearity is a statistical phenomenon that arises when there is a high degree of correlation between two or more independent variables. Collinear condition is present when one or more linear relationships exist among independent variables such that $\lambda_1 x_{1i} + \lambda_2 x_{2i} + \ldots + \lambda_k x_{ki} = 0$, where λ_i are constants and x_i are explanatory variables.

While multicollinearity among independent variables may not bias the resultant model, it could multiply by orders of magnitude the effect of bias from other problems. The presence of multicollinearity among independent variables could directly affect the predictive ability of the individual predictors in regression model or discriminant

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analyses. For example, it is widely recognized that because financial ratios are highly correlated, the standard errors of the regression coefficients tend to be very large; therefore, the resulting estimates of regression coefficients may become unstable or erratic and consequently of little value in determining the relative importance of the individual variables (Gordon, 1968; Mapp, 2007).

Other multicollinearity conditions among independent variables in which calculations of individual predictors may be affected include unequal intra-correlations of study subsets (the less redundant subsets vs. more redundant subsets); unequal presence of subsets may result in an artificially significant difference between the regression coefficients of the subsets in the study (Gordon, 1968). In other words, if the independent variables in subsets have unequal redundancy or heterogeneous correlations with the dependent variables, this may also lead to instability on the estimate of regression coefficients (Gordon, 1968; Mapp, 2007).

Eisenbeis (1977) contended that the problem of multicollinearity is in actuality a matter of degree; he also maintained that multicollinearity is a sample property, which should be of minimum concern in multiple discriminate analyses. There is the possibility in some studies that extraction of highly correlated variables could actually undermine the discriminatory power of the resultant discriminant model. That is, multicollinearity should only be an issue when it makes inversion of the dispersion matrices impossible, thus preventing the analysis of the study data (Eisenbeis 1977).

Clearly, what is most important in any studies requiring the use of financial ratios is that researchers need to be cognizant of the possibility of multicollinearity and its

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implications on the research data. This study employed variance inflation factor (VIF), noted by O'Brien (2007) as a means for detecting the presence of a multicollinearity problem in the predictor variables.

Several techniques are available that can be employed by researchers to improve the predictive power of MDA models. This research followed the footsteps of many researchers who have employed the stepwise regression analysis approach as a resolution to the problem of highly correlated financial ratios.

This researcher employed stepwise regression technique in an effort to isolate predictor variables that may lead to an ill-conditioned variance-covariance matrix. The binary dependent variable (CEO-Type1, CEO-Type2) served as the predictor (dependent) variable in the stepwise regression analysis.

After completed the stepwise analysis steps, during which variables that contributed to the ill-conditioned variance-covariance successfully screened out, then proceed with testing of the study hypothesis. Using the finalist predictor variables or the study model, the researcher was able to develop estimate of the relationships between new CEO successor origins (CEO-Type1 and CEO-Type2) and subsequent organizational performance.

Through MDA and stepwise discriminant analysis, the researcher achieved data transformation by simultaneously classifying observations into one of a priori groupings based on the characteristics which best 'discriminates' between the two groups (Altman, 1968). The commonly derived discriminant model is of the form $Z = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + \ldots + b_nX_n$. Where: Z = the score derived from application of the model; b_0

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is a constant use to adjust for the grand means, (see Klecka, 1980); $b_{1...}b_n$ are discriminant coefficients, which produce the characteristics of the function; and $X_{1...}X_n$ are independent variables (financial ratios) in the function. As the resulted "coefficients are applied to actual financial ratio, a basis for classification into one of the mutually exclusive groupings exists" (Altman, 1968, p. 562).

Generally, the vectors that resulted from the dependent variables are simplified to obtain a single linear or best discriminant function. For this study, the most significant financial ratios or best predictor variables were obtained, which were then employed to test the study hypothesis.

Using similar methods employed by Barber and Lyon (1996), the study specifically compared financial data obtained from the study sample of *Fortune* 500 companies, using statistical means to help remove the effect of industry-driven financial changes. Using financial indicators common across firms helped to assure more reliable pre- and post-succession firms' financial performance measures (Barber & Lyon, 1996).

This study also employed direct observations, which specifically entailed comparing financial indicators in this study to prevalent prior study financial measures to assign useful predictors. Conclusions relative to new CEO succession origins and subsequent firm performance reflected principally on the relationships uncovered between the independent and the dependent variables in this study.

The study used tables and charts not only as meaningful and efficient ways for connecting to the original intent of this study, but equally as a means to draw the reader's attention to the substance of the research findings. In other words, display of quantitative

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data in a research document is one of the many ways in which the researcher can generate uniquely meaningful interpretations of the research findings (Robson, 2002). The method that this study data was organized, also the method that findings were presented is consistent with quantitative research methodologies.

Validity and Reliability

There are many potential threats to validity in quantitative research design (including internal, external, and construct validity threats) that may threaten researchers' "…ability to conclude that the intervention affects an outcome" or when a study generalizes beyond the intended population (Creswell, 2003, p.171). The findings of this investigation may not be generalizable outside of the *Fortune* 500 companies. Additionally, it is not within the scope of this study to address all organizational changes resulting from new CEO succession events within firms included in this research.

The validity of the discriminant model can further be determined using various statistical techniques. Many model validation techniques have been suggested by researchers (e.g., Altman, 1968; Frank, Massy, & Morrison, 1965) mainly because of possible "sampling errors in the original sample [or because of] …bias inherent in the process of reducing the original set of variables to the best variable profile" (Altman, 1968, p. 600). Frank et al. (1965) suggested replications of the discriminant analysis procedure "…to obtain a better estimate of the proportion correctly classified, and hence the degree of bias, than would be available if the procedure were only followed once" (p. 254).

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This study employed descriptive statistics including comparing difference of means, analysis of variance, and investigating interrelationships among various outcomes; this approach is prevalent in similar quantitative studies (Cooper & Schindler, 2003). The study reliability reflected the "goodness of measure" and assurance of consistent measures across periods and across variables. Candor and truthfulness were important factors during every step of this study (Creswell, 2003). To enhance the study validity and reliability, the research method employed in this study reflected generally accepted quantitative research methodological approaches. The range of organization sizes or geographical regions represented by *Fortune* 500 companies may not be sufficient to generalize this study as representative of the entire US business population.

Expected Contribution to Knowledge

Knowledge was gained by understanding the relationships that are present between the study's independent and dependent variables; also, others can apply this knowledge in the CEO successor selection strategy in a similar case. More particularly, this study provided useful information for responding to the issues and challenges inherent in the CEO successor selection determination.

Ethical Considerations

Special circumstances pertain to some studies. Such is the case with this research, which has no informed consent requirement since the data applicable to this study is publicly available. Further, the researcher has no relationship with any of the organizations related to this study. The Institutional Review Board (IRB) application was completed and approved and all required CITI modules completed for this study.

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CHAPTER 4. RESULTS

Introduction

The purpose of this empirical research was to investigate the relationship between new CEO succession origins and the organizational financial performance during the consecutive two years following succession. This chapter reflects the cumulative research efforts including the CEO succession literature and theories reviewed in chapter two, and the quantitative research methodology design described in chapter three. The data and tables presented in the subsequent pages of this chapter provide the evidence for the specific purpose of answering the research question regarding the relationship between new CEO successor origins and post-succession organizational performance of the *Fortune* 500 companies in the United States.

The population and the source of data for this quantitative empirical study comprised of U.S. firms listed in the 2003 *Fortune* 500 (see Appendix A). The *Fortune* 500 is the list of top U.S. firms as ranked by their financial standings. The initial sample was collected using non-probability purposive sampling methodology, was composed of 110 *Fortune* 500 companies that experienced new CEO succession during the years 2004 to 2005 (see Appendix B).

The final sample used for collecting pertinent data consisted of 56 firms, equally divided between firms that employed insider CEOs or CEO-Type1 and firms that

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employed outsider CEOs or CEO-Type2 (see Appendix C). The final sample excluded 54 firms that had reported multiple new CEO succession events during the study period, hence disqualified from this study.

The subsequent section of this chapter delineate three key components of the research including descriptive accounts of the research data collection process, followed by the statistical data analysis process used in the research, and most importantly, this chapter reports research findings and the theory that emerged relative to the research question.

Research Data Collection

The empirical data used to support this study came from publicly available *Fortune* 500 companies' financial statements. After the final sample had been determined, the researcher began collecting financial data from the balance sheet and income statement of the 56 finalist *Fortune* 500 firms. The pertinent empirical financial data used in this study represented two data periods: the first period covered the year prior to new CEO succession or Yr-1, and the second period covered the consecutive two years following new CEO succession or Yr+1 and Yr+2.

This study benefited from unfettered access to relevant secondary financial data due to current informational technology advancements. More particularly, recent internet technology advancements facilitated the collection of relevant empirical data across firms very quickly and efficiently; this effort would have otherwise been logistically difficult and costly.

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The following data collection steps provide descriptive validity to the research process and support the reliability of the quantitative data used in this study. First, the researcher created and populated an excel database file using only the *Fortune* 500 firms identified in the final study sample (see Appendix C). Next, the researcher conducted several Web searches (used firms in Appendix C as search criteria) to obtain the applicable annual financial reports. The annual financial reports included the balance sheet and income statement that ultimately represented the primary data sources and basis for the subsequent data analysis section of this study.

Table 4, Table 5, and Table 6 presented the mean value of each financial statement component from the *Fortune* 500 companies' annual financial reports for both the CEO-Type1 and CEO-Type2 firms.

Table 4 represented the consecutive two-years (Yr+1 & Yr+2) post-succession balance sheet financial mean values collected from both CEO-Type1 and CEO-Type2 firms.

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Table 4. Consecutive Two-Year Post-Succession Balance Sheet ($ mil.) (n=28)

	CEO-Type1 Mean Value	CEO-Type2 Mean Value	Combined Mean Values
Current Assets:			
Cash	21,197,000	1,635,000	22,832,000
Receivables	3,747,000	4,457,000	8,204,000
Inventory	1,745,000	2,011,000	3,756,000
Total Current Assets	37,349,000	10,647,000	47,996,000
Long Term Assets:			
Investments	36,396,000	29,313,000	65,709,000
Fixed Assets	8,493,000	6,673,000	15,166,000
Total L/Term Assets	56,311,000	44,568,000	100,879,000
Total Assets	93,660,000	55,215,000	148,875,000
Current Liabilities:			
Accounts Payable	6,021,000	7,729,000	13,750,000
Total Current Liab.	53,701,000	15,379,000	69,080,000
Long Term Liabilities:			
Total L/Term Liab.	29,186,000	30,726,000	59,913,000
Total Liabilities	82,887,000	46,105,000	128,992,000
Equity:			
Total Equity	10,767,000	9,110,000	19,877,000

Table 5 represented the consecutive two-years (Yr+1 & Yr+2) post-succession income statement financial mean values collected from both CEO-Type1 and CEO-Type2 firms.

Table 5. Consecutive Two-Year Post-Succession Income Statement ($ mil.) (n=28)

	CEO-Type1 Mean Value	CEO-Type2 Mean Value	Combined Mean Values
Revenue (Sales)	24,706,000	19,879,000	44,584,000
Cost of Revenue	13,328,000	10,689,000	24,017,000
Gross Margin	11,378,000	9,189,000	20,567,000
Total Operating Expenses	6,753,000	7,173,000	13,926,000
Operating Margin	4,625,000	2,017,000	6,642,000
Earnings before Int. &Taxes	4,820,000	2,200,000	7,020,000
Interest Expenses	2,741,000	308,000	3,049,000
Income Tax Expenses	558,000	613,000	1,170,000
Net Income from Operations	1,507,000	1,248,000	2,754,000
Net Income/ (Loss)	1,579,000	1,383,000	2,962,000

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Table 6 represented the prior year (Yr-1) financial statement mean values collected from both CEO-Type1 and CEO-Type2 firms.

Table 6. Prior Year (Yr-1) Financial Statement ($ mil.) (*n*=28)

	CEO-Type1 Mean Value	CEO-Type2 Mean Value	Combined Mean Values
Current Assets	25,808,000	7,829,000	33,637,000
Long Term Assets	38,906,000	32,778,000	71,684,000
Total Assets	64,714,000	40,607,000	105,321,000
Current Liabilities	36,497,000	11,400,000	47,897,000
Long Term Liabilities	19,835,000	22,778,000	42,613,000
Total Liabilities	56,332,000	34,178,000	90,510,000
Equity	8,382,000	6,429,000	14,811,000
Revenue (Total Sales)	19,936,000	15,214,000	35,150,000
Net Income/ (Loss)	1,161,000	646,000	1,807,000

Statistical Data Analysis

The statistical data analysis process is consistent with the research methodology design described in chapter three. Additionally, the statistical data analysis performed in this study was analogous to those performed in previous studies (e.g. Beatty & Zajac, 1987; Cannella & Lubatkin, 1993; Friedman & Singh, 1989; Furtado & Karan, 1990; Puffer & Weintrop, 1991).

In performing the data analysis process, the researcher followed three basic steps. First, evaluated and conducted comparative review of the research data; second, segmentized the study predictor variables into three prevalent performance measurement categories including Profitability, Leverage, and Efficiency; finally, performed data analysis using statistical and mathematical means to determine the predictive power of

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the independent variables. From a quantitative ideological point of view, this is where the researcher, through descriptive segmentation, searched for variables with the predictive power to answer the research question (Gephart, 1999).

Research Data Evaluation

The researcher evaluated the financial statement data to ascertain commonality and robustness across the sample firms. More important, the evaluation performed on the financial data allowed the researcher to detect any reportable data anomalies, thereby ensuring the alignment and relevance of the research data to the discourse that followed.

Comparative Review of the Research Data

Using the empirical financial data extracted from the final sample firms, the researcher conducted preliminary financial performance comparison between CEO-Type1 and CEO-Type2 firms. The purpose of this comparative review was to assess the robustness and particularly, the elasticity of the reported post-succession versus pre-succession research data for CEO-Type1 and CEO-Type2 firms (see Table 7).

Table 7. Post-Succession in Relation to Pre-Succession Average Performance Value

	CEO-Type1 (*n*=28)	CEO-Type2 (*n*=28)
Current Assets	1.4472	1.3599
Long Term Assets	1.4474	1.3597
Total Assets	1.4473	1.3597
Current Liabilities	1.4714	1.3490
Long Term Liabilities	1.4714	1.3489
Total Liabilities	1.4714	1.3490
Equity	1.2845	1.4170
Revenue (Total Sales)	1.2393	1.3066
Net Income/ (Loss)	1.3600	2.1409

(e.g., for CEO-Type1, Post-Succession Ave. Current Assets is 144.72% of Pre-Succession Value).

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The following section provided descriptive comparison of the performance differences in key financial areas between CEO-Type1 versus CEO-Type2 firms, based on the research data extracted from the final sample firms (see Tables 4, 5, & 6). For example, CEO-Type1 firms reported relatively higher post-succession average total assets ($93.66 billion) compared to the average total assets ($55.21 billion) reported by CEO-Type2 firms.

Additionally, the following post-succession financial performance differences between CEO-Type1 and CEO-Type2 firms were noticeable:

CEO-Type1 firms enjoyed relatively higher average cash assets ($21.19 bil.) compared to CEO-Type2 firms' average cash assets ($1.63 bil.).

CEO-Type1 firms recorded relatively favorable average receivable assets ($3.74 bil.) compared to CEO-Type2 firms' average receivable assets ($4.45 bil.).

CEO-Type1 firms recorded relatively higher average current assets ($37.34 bil.) compared to CEO-Type2 firms' average current assets ($10.64 bil.).

CEO-Type1 firms reported relatively higher average long-term assets ($56.31 bil.) compared to average long-term assets ($44.56 bil.) reported for CEO-Type2 firms.

CEO-Type1 firms reported relatively favorable average total equity ($10.76 bil.) compared to CEO-Type2 firms' reported average total equity ($9.11 bil.).

CEO-Type1 firms also reported relatively favorable average net income ($1.57 bil.) compared to CEO-Type2 firms' reported average net income ($1.38 bil.).

CEO-Type1 firms reported relatively better average total revenue ($24.70 bil.) compared to CEO-Type2 firms' average total revenue from sales ($19.87 bil.).

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Finally, CEO-Type1 firms also recorded moderately higher average gross margin ($11. bil.) compared to the average gross margin ($9.18 bil.) recorded by CEO-Type2 firms. Based on the review of key financial data, CEO-Type1 firms consistently reported relatively favorable post- succession performances compared to CEO-Type2 firms.

Performance Measurement Categories

To enhance the data analysis process, the researcher grouped the study predictor variables into three commonly used organizational performance measurement categories, which include profitability, leverage, and efficiency measures. The study employed twenty-four (24) predictor variables, selected based on their predictive classifications in prior relevant studies as important performance measures, and based on their potential relevancy in the current study.

The first categories of measures are profitability ratios. Table 8 presented the predictor variables associated with the organizational profitability measures. Profitability predictor variables are important and effective financial metrics for assessing organizational abilities to

Table 8. Organizational Profitability Predictor Variables

	Variables	Calculations
Var1	Return on Revenue (ROR)	Net Income/Revenue
Var2	Return on Assets (ROA)	Net Income/Total Assets
Var3	Earning Power	Net Income/Fixes Assets + Inv.

generate earnings. In addition, these measures usually reflect the effectiveness of the organizational leaders. Generally, the stakeholders accord greater respect to organizational leaders with favorable profitability results.

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The second categories of measures are leverage ratios. Table 9 presented the predictor variables associated with the organizational leverage measures. Leverage

Table 9. Organizational Leverage Predictor Variables

	Variables	Calculations
Var4	Cash Percent	Cash/Total Assets
Var5	Current Assets Percent	Current Assets/Total Assets
Var6	Current Liabilities Percent	Current Liabilities/Total Assets
Var7	Cash to Current Liabilities	Cash/Current Liabilities
Var8	Current Ratio	Current Assets/Current Liabilities
Var9	Current Assets Turnover	Revenue/Current Assets

predictor variables are important and effective financial metrics for assessing organizational liquidity posture, operating effectiveness, and the ability to take advantage of existing operating capabilities. The focus of leverage ratios includes organizational financial structure, specifically, the organizational ability to meet current financial obligations or ability to manage current assets and current liabilities. A high percentage of current assets generally indicate firms' ability to satisfy short-term obligations upon demand. Based on the research data extracted from the final study sample (see Tables 4, 5, & 6), CEO-Type1 firms enjoyed relatively favorable post-succession organizational liquidity compared to CEO-Type2 firms.

The third categories of measures are efficiency ratios. Table 10 presented the predictor variables associated with the organizational efficiency measures. Efficiency predictor variables are a collection of organizational performance measures; these measures are specifically effective in explicating organizational operating efficiencies. The most commonly employed organizational efficiencies measures include: cash to revenue, receivable to revenue, inventory turnover, working capital to revenue, fixed

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assets to revenue, total asset turnover, equity to revenue, and return on equity. Based on

Table 10. Organizational Efficiency Predictor Variables

	Variables	Calculations
Var10	Cash to Revenue	Cash/Revenue
Var11	Receivables to Revenue	Current Receivables/Revenue
Var12	Inventory Turnover	Cost of Goods Sold/Inventory
Var13	Working Capital to Revenue	Current Assets – Current Liab./Rev.
Var14	Fixed Assets to Revenue	Net Fixed Assets/Revenue
Var15	Total Asset Turnover	Revenue/Total Assets
Var16	Equity to Revenue	Total Assets-Total Liabilities/Rev.
Var17	Revenue per Employee	Revenue/Number of Employees
Var18	Gross Margin Percent	Revenue – COGS/Revenue
Var19	Gross Margin RO Inventory	Gross Margin/Inventory
Var20	GM Return on Mer. Investment	GM/Inv. + Acct. Rec. - Acct. Pay.
Var21	Return on Equity	Net Income/Total Liabilities
Var22	Revenue Growth	Revenue CY- Revenue PY/Rev. PY
Var23	Long Term Liabilities Percent	Long Term Liabilities/Total Assets
Var24	Income to Long Term Liabilities	Net Income/Long Term Liabilities

the research data extracted from the final study sample (see Tables 4, 5, & 6), *Fortune* 500 CEO-Type1 firms experienced relatively favorable efficiency performance compared to *Fortune* 500 CEO-Type2 firms during the study period.

Performance Measurement Descriptive Statistics

The descriptive statistics compiled by the researcher, based on relevant financial performance measures or key financial ratios serve to normalize the impact of organizational size; providing consistent symmetries, characterized by harmonious proportions in the variables of interest relative to the research topic. The resulted performance measurement variables or ratio variables presented in Table 11 are segregated based on performance measurement categories and serve as the basis for all subsequent post-succession related statistical analysis in the current research.

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The ratio variables presented in Tables 11 and 12 are the basis of all inferences about the study population.

Table 11. Post-Succession Organizational Performance Factor

	Financial Ratios/Ratio Variables		CEO-Type1 (*n*=28)	CEO-Type2 (*n*=28)
Profitability Ratios:	Var1	Return on Revenue (ROR)	0.064	0.070
	Var2	Return on Assets (ROA)	0.017	0.025
	Var3	Earning Power	0.154	0.159
Leverage Ratios:	Var4	Cash Percent	0.226	0.030
	Var5	Current Assets Percent	0.399	0.193
	Var6	Current Liabilities Percent	0.573	0.279
	Var7	Cash to Current Liabilities	0.395	0.106
	Var8	Current Ratio	0.695	0.700
	Var9	Current Assets Turnover	0.661	0.967
Efficiency Ratios:	Var10	Cash to Revenue	0.858	0.082
	Var11	Receivables to Rev.	0.152	0.224
	Var12	Inventory Turnover	7.638	5.315
	Var13	Working Capital to Rev.	-0.662	-0.238
	Var14	Fixed Assets to Rev.	0.344	0.336
	Var15	Total Asset Turnover	0.264	0.360
	Var16	Equity to Revenue	0.436	0.458
	Var17	Rev. per Employee	301.109	386.180
	Var18	Gross Margin %	0.461	0.462
	Var19	Gross Margin RO Invtry.	6.520	4.569
	Var20	Gross Margin RO M/Inv.	21.509	7.287
	Var21	Return on Equity	0.147	0.152
	Var22	Revenue Growth	0.239	0.307
	Var23	Long Term Liab. %	0.310	0.560
	Var24	Income to Total L/T Liab.	0.054	0.045

The performance measurement variables shown in Table 12 specifically serve as the basis for all subsequent pre-succession related statistical analysis in the current research.

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Table 12. Pre-Succession Organizational Performance Factor

	Financial Ratios/Ratio Variables		CEO-Type1 (*n*=28)	CEO-Type2 (*n*=28)
Profitability Ratios:	Var1	Return on Revenue (ROR)	0.058	0.042
	Var2	Return on assets (ROA)	0.018	0.016
Leverage Ratios:	Var5	Current Assets Percent	0.399	0.193
	Var6	Current Liabilities Percent	0.564	0.281
	Var8	Current Ratio	0.707	0.687
	Var9	Current Assets Turnover	0.772	0.943
Efficiency Ratios:	Var13	Working Capital to Revenue	-0.536	-0.235
	Var15	Total Asset Turnover	0.308	0.375
	Var16	Equity to Revenue	0.420	0.423
	Var21	Return on Equity	0.021	0.019
	Var23	L/Term Liabilities Percent	0.307	0.561
	Var24	Income to L/Term Liabilities	0.059	0.028

Analysis of Ratio Variables

The following section presents descriptive and comparative analysis of the post-succession ratio variables calculated from the data extracted from the final sample *Fortune* 500 firms (see Table 11).

Ratios Var1 to Var3 (see Table 11) are three relevant accounting measures employed by the researcher to assess the organizational profitability barometers, including return on revenue, return on assets, and the ability to generate earning. Detailed examination of these ratio variables revealed CEO-Type2 firms performed slightly better in all three profitability measures when compared to CEO-Type1 firms during the post-succession years of the study period.

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Ratios Var4 to Var7 (see Table 11) are prevalent accounting measures used in assessing current organizational operating capabilities also referred to as liquidity posture. The current organizational operating capabilities measures used in the current study include: the percentages of cash on hand relative to total assets; the percentage of all current assets relative to total assets; the percentage of all current liabilities relative to total assets; and the percentage of all cash on hand relative to all current liabilities.

Detailed examination of all the current organizational operating capabilities measures revealed that CEO-Type1 firms performed slightly better when compared to CEO-Type2 firms during the study period.

Ratios Var8 and Var9 (see Table 11) are other relevant accounting measures employed to assess current organizational liquidity capabilities. These two accounting measures, which include current ratio or current assets relative to current liabilities, and current assets turnover or total revenue relative to total current assets, are means to determine organizational operating and liquidity posture. Examination of these measures revealed CEO-Type2 firms performed better when compared to CEO-Type1 firms during the post-succession years in this study. For example, the CEO-Type2 firms reported current ratio and current assets turnover factors of 0.700 and 0.967 respectively, compared to the factors of 0.695 and 0.661 reported by CEO-Type1 firms during the post-succession years of this study (see Table 11).

Ratios Var10 to Var24 (see Table 11) are collections of relevant organizational efficiency measures employed in this study: Ratio variable R10 measures the cash to revenue factor or the relationship between cash on hand and total operating revenues

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during the post-succession years of this study. Examination of this measure revealed CEO-Type1 firms reported factor of 0.858 significantly surpassed CEO-Type2 firms, which reported factor of 0.082 for the same period.

Ratio Var11 measures the current receivables to revenue factor or the relationship between current receivables and total operating revenues during the post-succession years of this study. Examination of this measure revealed CEO-Type2 firms performed relatively better with the reported factor of 0.224 compared to the factor of 0.152 reported by CEO-Type1 firms for the same period.

Ratio Var12 measures the inventory turnover factor or the relationship between costs of goods sold and total outstanding inventories performance during the post-succession years of the firms in the study sample. Examination of this measure revealed CEO-Type2 firms performed relatively better with the reported inventory turnover factor of 5.315 days, compared to the reported turnover factor of 7.638 days for CEO-Type1 firms during the same period.

Ratio Var13 measures the relationship between working capital and total revenues or the quotients of the (current assets minus current liabilities) / revenue; this measure gave CEO- Type2 firms a nearly 3 to1 advantage over CEO-Type1 firms in the study post-succession years.

Ratio Var14 measures the fixed assets to revenue factor or the relationship between net fixed assets and total operating revenues during the post-succession years of this study. Detailed examination of this measure revealed nearly identical performances for both CEO-Type1 and CEO-Type2 firms' post-succession performance.

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Ratio Var15 measures the total assets turnover or the relationship between total operating revenue and firms' total assets during the post-succession years of this study. Examination of this measure revealed CEO-Type2 firms performed relatively better with the reported measure of 0.360 compared to the factor of 0.264 reported by CEO-Type1 firms during the post-succession years among the study sample.

Ratio Var16 measures the equity to revenue factor or the relationship between total equities and total revenues during the post-succession years of this study. This ratio variable provides an indication of when firms are at high risk or highly leveraged. Examination of this measure revealed nearly identical performances for both CEO-Type1 and CEO-Type2 firms during the post-succession years of the study sample.

Ratio Var17 measures the average value of revenue generated per employee or the labor productivity values for the research period. Examination of this measure revealed CEO-Type2 firms performed relatively better with the reported factor of 386.180 per employee compared to the factor of 301.109 per employee reported by CEO-Type1 firms during the same period.

Ratio Var18 measures the gross margin percent; Ratio Var19 measures gross margin return on inventory; and Ratio Var20 measures gross margin return on merchandise investments. The gross margin percent determines funds available for operating expenses; gross margin return on inventory and investment measures efficiency in leadership decisions relating to inventory and investments. In this study, the gross margin factor reported revealed nearly identical performances for both CEO-Type1 and CEO-Type2 firms. For the gross margin return on inventory and the gross margin return

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on merchandise investments, CEO-Type1 firms experienced favorable efficiency when compared to CEO-Type2 firms during the study period.

Ratio Var21 measures returns on equity; and RatioVar22 measures the overall organizational revenue growth for the post-succession period compared to the pre-succession year revenue. In both measures, CEO-Type2 firms enjoyed slightly favorable performances when compared to CEO-Type1 firms during the study period.

Finally, ratio Var23 and Var24 measure the overall financial structure and stability of the organization. In both measures, CEO-Type1 firms performed slightly favorable when compared to CEO-Type2 firms for overall financial structure and organizational stability.

Researchers have commonly benchmarked financial ratios to the related industry rate of return; by doing so, the resulted measures were industry-adjusted in order to compare performance across firms. The guiding principle in doing this is to scale operating performance, for example, 'period t-1' total revenues divided by 'period t-1' total assets. In this case, the researcher benchmarked simply by dividing current period average operating values by the average of the combined values of the beginning and ending period values of the corresponding measure. However, many prior studies have compared the scaled operating performance results to the non-scaled end-of-period measures; and the basic tenor of their conclusions are generally unaffected one way or the other (Barber & Lyon, 1996). Hence, this study employed the average end-of-period financial measures based on the research data extracted from the final study sample of *Fortune* 500 firms.

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Multicollinearity Analysis

The issue of multicollinearity results from high degree of correlation between variables; hence, it is a common concern when using financial ratios in statistical analysis. Although this statistical phenomenon does not bias the results or reduce the collective predictive power of the study variables, it does affect the ability of individual predictor variable to yield the optimal prediction function. While there are several approaches to dealing with multicollinearity concerns, none could actually produce a permanent cure. The discriminant analysis technique is one of the most employed among the various methods for determining the best group of discriminating financial ratios in prior studies.

Discriminant Analysis

Tabachnick and Fidell, (1983) argued that, when dealing with the problem of highly correlated variables, it is necessary that only the most relevant variables should be included in the discriminant analysis. Table 13 presented the 24 financial ratios selected for the initial statistical evaluation in the current study. The researcher selected these 24 ratio variables (see table 13) based on the following two key factors: 1) consideration in previous studies as important financial measures, and 2) determination as relevant in the current study. Since financial ratios are highly correlated in nature, using the discriminant statistical analysis in conjunction with prior studies' classifications of financial ratios allowed the researcher to deal with this concern in one of two ways: removed or retained.

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Table 13. Relevant Financial Ratios Included in Discriminant Analysis

Category	Variable	Description
Profitability Ratios:	Var1	Return on Revenue (ROR) or Net Income/Revenue
	Var2	Return on Assets (ROA) or Net Income/Total Assets
	Var3	Earning Power or Net Income/Fixes assets + Inventory
Leverage Ratios:	Var4	Cash Percent or Cash/Total Assets
	Var5	Current Assets Percent or Current Assets/Total Assets
	Var6	Current Liabilities Percent or Current Liab./Total Assets
	Var7	Cash to Current Liabilities or Cash/Current Liabilities
	Var8	Current Ratio or Current Assets/Cur. Liabilities
	Var9	Current Assets Turnover or Revenue/Current Assets
Efficiency Ratios:	Var10	Cash to Revenue or Cash/Revenue
	Var11	Receivables to Revenue or Current Receivables./Revenue
	Var12	Inventory Turnover or Cost of Goods Sold/Inventory
	Var13	Working Capl to (Curr. Assets - Current Liab)./Rev
	Var14	Fixed Assets to Revenue or Net Fixed Assets/Revenue
	Var15	Total Asset Turnover or Revenue/Total Assets
	Var16	Equity to Rev. or Total Assets-Total Liabilities/Rev.
	Var17	Revenue per Employee or Revenue/Number of Employees
	Var18	Gross Margin Percent or Revenue - COGS/Revenue
	Var19	Gross Margin RO Inventory or Gross Margin/Inventory
	Var20	Return on ((GM /Inv.) + Acct. Rec). - Acct. Pay.
	Var21	Return on Equity or Net Income/Total Liabilities
	Var22	Revenue Growth or Revenue CY- Revenue PY/Rev. PY
	Var23	L/Term Liabilities Percent or LTerm Liab./Total Assets
	Var24	Income to L/Term Liab. or Net IncomeL/Term Liab.

The next approach toward selection of ratio variables with the most discriminating power among the 24 ratio variables (see table 13) was to create a sub-group of ratio variables. For the sake of parsimony, Table 14 presented a sub-group of ratio variables that have shown considerable merit, including commonality across the sample *Fortune* 500 firms and across the study periods; and have demonstrated the potential for significant predictive power to produce best predictor variables based on prior studies. The use of prior research classifications of financial ratios served as an

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effective mining technique for removing non-discriminatory ratio variables prior to any additional statistical analysis to determine ratio variables with the most discriminating power for the current study.

The initial reduction process employed forward selection, sequentially evaluating each ratio variable starting with the most highly correlated. The researcher evaluated and initially retained the following ratio variables: Var1- returns on revenue, ratio Var2 - returns on assets, and ratio Var3 - earnings power; all considered in previous studies as important organizational financial performance measures (Cronin & Skinner, 1984).

Ratio Var4 - cash percent, although highly correlated, initially retained because of its discriminating power over other highly correlated variables; also considered in the literature as an important predictor variable (Deakin, 1976).

Ratio Var5 - current assets percent, ratio Var6 - current liabilities percent, ratio Var7 - cash to current liabilities, and ratio variable R8 - current operating ratio, are all highly correlated; however, regarded as a very important organizational operating performance measure (Cronin & Skinner, 1984). All, except ratio Var7, initially retained; the researcher removed ratio Var7 for lacking sufficient predictive power compared to the other variables.

Ratio Var12- inventory turnover, was determined to be highly correlated with ratio Var9 - current assets turnover, ratio Var10- cash to revenue, and ratio Var11 - receivables to revenue.

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Table 14. Initial Financial Ratios with Significant Discriminating Power

	Financial Ratios/Ratio Variables		Significant (Yes/No)
Profitability Ratios:	Var1	Return on Revenue (ROR)	Yes
	Var2	Return on Assets (ROA)	Yes
	Var3	Earning Power	Yes
Leverage Ratios:	Var4	Cash Percent	Yes
	Var5	Current Assets Percent	Yes
	Var6	Current Liabilities Percent	Yes
	Var7	Cash to Current Liabilities	No
	Var8	Current Ratio	Yes
	Var9	Current Assets Turnover:	Yes
Efficiency Ratios:	Var10	Cash to Revenue	No
	Var11	Receivables to Revenue	No
	Var12	Inventory Turnover	Yes
	Var13	Working Capital to Revenue	Yes
	Var14	Fixed Assets to Revenue	No
	Var15	Total Asset Turnover	Yes
	Var16	Equity to Revenue	Yes
	Var17	Revenue per Employee	No
	Var18	Gross Margin Percent	No
	Var19	Gross Margin RO Inventory	No
	Var20	GM Return on Mer. Invest.	No
	Var21	Return on Equity	Yes
	Var22	Revenue Growth	No
	Var23	Long Term Liab. Percent	Yes
	Var24	Income to Long Term Liabilities	Yes

Note: Initially selected variables are boldface, subsequently paired and retained or eliminated based on the contributory power of each variable.

However, current assets turnover (Var9) and inventory turnover (Var12) represent a critical stability and efficiency measure and important barometer of organizational solvency; hence, the researcher initially retained both ratio Var9 and ratio Var12, and removed both ratio Var10 and ratio Var11 from consideration for lack of meaningful predictive power.

Ratio Var13 - working capital to revenue, ratio Var15 - total assets turnover, ratio Var16 - equity revenue, ratio Var21 - return on equity, ratio Var23 - long-term liabilities

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percent, and ratio Var24 - income to total long-term liabilities, all highly correlated but initially retained for additional analysis because they are important to the current study.

Ratio Var14 - fixed assets to revenue, ratio Var17 - revenue per employee, ratio Var18 - gross margin percent, ratio Var19 - gross margin return on inventory, ratio Var20 - gross margin return on merchandise investment, and ratio Var22 - revenue growth, are highly correlated and lacking in predictive power hence removed from further consideration in the current study.

The initial sub-groups of significant ratios variables selected (see Table 14) then subjected to additional forward selection statistical evaluation; each ratio variable paired one after the other stating with the most highly correlated ratio variable in the group.

Rather than merely focusing on generating a linear discriminant function from an empirical artifact, the researcher ensured that the research question was at the center of consideration. In other words, any claim regarding the optimality of the resulting discriminant function could only be meaningful if it resolved the research question (Altman, 1968).

Following an exhaustive evaluation of the initially selected ratio variables, the researcher retained the seven best overall predictor variables summarized in Table 15 to answer the research question in the current study. The basis for selecting these seven best predictor variables is rooted in their apparent relevancy in the current study; in addition, these seven ratio variables have also demonstrated in prior related studies to be the best discriminating predictor variables and the most commonly employed financial performance indicators of firm problems.

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Table 15. Summary of Best Predictor Financial Ratios in Current Study

Category	Variable	Ratio
Profitability Ratios:	Var2	Return on Assets (ROA) or Net Income/Total Assets
Leverage Ratios:	Var6	Current Liab. Percent or Current Liab./Total Assets
	Var9	Current Assets Turnover or Revenue/Current Assets
Efficiency Ratios:	Var15	Total Asset Turnover or Revenue/Total Assets
	Var16	Equity to Rev. or Total Assets-Total Liab./Rev.
	Var21	Return on Equity or Net Income/Total Liabilities
	Var23	L/T Liab. Percent or Long Term Liab./Total Assets

The seven best predictor variables shown in Table 15 specifically accounted for the three key ratio categories of organizational performance measures articulated in this study, which include profitability ratios, leverage ratios, and efficiency ratios respectively.

The best predictor variable retained for the profitability measure in the current study is the ratio Var2 - return on assets or net income to total assets. Ratio Var2 is relevant to the present study; also, it is the most commonly employed profitability measure in the literature (Altman, 1968).

The best predictor variables retained for the leverage measure include ratio Var6 - current liabilities percent or current liabilities to total assets; and ratio Var9 - current assets turnover or total revenues to current assets. Both predictor variables are highly relevant to the present study.

Finally, the efficiency measure best predictor variables retained include ratio Var15 - total assets turnover or total revenues to total assets; ratio Var16 - equity to total revenues or total assets minus total liabilities to total revenues; ratio Var21 - return on

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equity or net income to total liabilities; and ratio Var23 - long-term liabilities percent or long-term liabilities to total assets. The selected best predictor variables demonstrated in this study, as in many prior related studies, to be particularly relevant in the quest to understand the relationship between new CEO successor origins and subsequent organizational financial performance. These seven best predictor variables provided useful comparative data points in the present study relative to CEO-Type1 versus CEO-Type2 selection decisions among *Fortune* 500 companies.

Research Findings

The statistical data analysis conducted in the present study, like in many quantitative studies, provided the basis for reported research findings and specifically fueled the discovery of an answer to the research question. The following section of this chapter reported the data anomaly discoveries, the hypothesis testing, and the comparative results of the statistical analysis conducted to answer the research question.

Research Data Anomalies

The researcher detected no any reportable anomalies in the research data collected, which could have affected the outcome of this study.

Hypothesis Testing

The financial performance results (see Tables 16, 17, & 18) showed two very interesting dichotomous points of view for this study. The first part of these results, presented in Table 16 and Table 17, provided clear evidence that supports the study hypothesis, which posited that selection of an insider CEO successor (CEO-Type1) or an outsider CEO successor (CEO-Type2) would result in no significantly different

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subsequent or post-succession organizational financial performance using critical Accounting-Based financial performance measures.

The second part of the results presented in Table 18 showed side-by-side evidence, which suggest that new outsider CEO successors are clearly capable of moving the organization in the right direction financially. In other words, given financial outcomes as the primary measures of organizational performance, outsider CEOs (CEO-Type2s) are as capable as insider CEOs (CEO-Type1s), if not slightly better, based on the financial performance evidence gathered from a sample of 56 *Fortune* 500 companies. The following section provides additional details of the theory, evidence, and findings of this study.

Table 16. Pre vs. Post-Succession Financial Performance, CEO-Type1 Firms

Categories	Ratio Variables		Pre-Yr Factor	Post-Yr Factor
Profitability Ratios:	Var2	Return on Assets (ROA)	0.018	0.017
Leverage Ratios:	Var6	Current Liabilities Percent	0.564	0.573
	Var9	Current Assets Turnover	0.772	0.661
Efficiency Ratios:	Var15	Total Asset Turnover	0.308	0.264
	Var16	Equity to Revenue	0.420	0.436
	Var21	Return on Equity	0.021	0.147
	Var23	L/Term Liabilities Percent	0.307	0.310

Comparative Results to Answer the Research Question

The comparative results presented in Table 16, Table 17, and Table 18 provides the corroborative evidence, which allowed the researcher to answer the research question for this study. The research question posited for this study: Is there a relationship between new CEO successor origins and post-succession organizational financial

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outcomes? The discovery of the answer to the research question was a direct result of the research data analysis conducted.

Table 16 compared the CEO-Type1 firms' pre-succession versus post-succession financial performance using the best predictor variables; the results showed almost identical economic outcomes for both periods. These results provide valuable evidence, which supports prevailing argument, that selection of CEO-Type1, with ties to tradition and precedents, constitutes continuity of the status quo in most cases (Friedman & Saul, 1991). In addition, the limited elasticity of the results in Table 16 also suggests that CEO-Type1 constitute routine tenure; therefore, power transition is independent of firm performance.

Table 17. Pre vs. Post-Succession Financial Performance, CEO-Type2 Firms

Categories	Ratio Variables		Pre-Yr Factor	Post-Yr Factor
Profitability Ratios:	Var2	Return on Assets (ROA)	0.016	0.025
Leverage Ratios:	Var6	Current Liabilities Percent	0.281	0.279
	Var9	Current Assets Turnover	0.943	0.967
Efficiency Ratios:	Var15	Total Asset Turnover	0.375	0.360
	Var16	Equity to Revenue	0.423	0.458
	Var21	Return on Equity	0.019	0.152
	Var23	L/Term Liabilities Percent	0.561	0.560

Similarly, CEO-Type2 firms' pre-succession financial performance versus post-succession financial performance (see Table 17) showed no significantly different financial performance for all the predictor variables. Nonetheless, the results showed that CEO-Type2 firms' economic performance in most of the measures was slightly better when compared to CEO-Type1 firms.

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Furthermore, based on economic outcomes reported in Table 17, this study did not detect any immediate unfavorable post-succession disruption commonly anticipated following new outsider CEO successors selection decision. However, since disruption may be a direct response to subsequent actions by new outsider CEO successors, "…disruption would not necessarily be poor because disruption may be a necessary step along the path toward adaptive organizational change" (Friedman & Saul, 1991 p. 622). Additional interpretation of the results presented in Tables 17 and 18 suggests that economic performance constitutes important evidence that the selection of CEO-Type2 successor was an appropriate decision.

Table 18 results compared financial performance measures of CEO-Type1 versus CEO-Type2 firms using the seven best predictor variables. In this comparison, CEO-Type2 firms showed slightly favorable financial performance results over CEO-Type1 firms in all listed best predictor variables except for ratio variable R23. The effect of ratio variable R23 - long-term liabilities percent, in this case, was effectively nullified by ratio variable R6 - Current-term liabilities percent for CEO-Type2 firms.

Table 18. Post-Succession Seven Best Predictor Variables

Categories	Ratio Variables		CEO-Type1	CEO-Type2
Profitability Ratios:	Var2	Return on Assets (ROA)	0.017	0.025
Leverage Ratios:	Var6	Current Liabilities Percent	0.573	0.279
	Var9	Current Assets Turnover	0.661	0.967
Efficiency Ratios:	Var15	Total Asset Turnover	0.264	0.360
	Var16	Equity to Revenue	0.436	0.458
	Var21	Return on Equity	0.147	0.152
	Var23	L/Term Liabilities Percent	0.310	0.560

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Clearly, the expectation of stakeholders differs with respect to CEO origins (Fredrickson, et al., 1988). Since CEO-Type2 successors' selection most likely resulted during organizational economic downturns, performance expectations are generally higher than would be for CEO-Type1 successors (Tushman & Romanelli, 1985).

Summary

The preceding section of this study described the data collection and findings of the analysis conducted in an effort to answer the stated research question and to test the study hypothesis. The researcher employed the accounting indicators, which reflected the operational performance across a sample of 56 *Fortune* 500 companies, as the primary post-possession financial performance measures.

In the interest of parsimony, the analytical process utilized multivariate discriminant analysis classifications, validated in various prior empirical studies, as the basis for selecting the predictor variables that are most significant in the current study. The final seven best predictor variables selected provided the needed evidence to help answer the research question. This study avoids providing merely one-dimensional linear discriminant model; instead, the research findings provide an evidence-based platform that is useful to organizational leaders in selecting the best new CEO successor candidate. The important take-away from the findings of this study is knowing that selecting an insider or an outsider CEO successor would result in no significantly different post-succession financial performance; as long as the board of directors is armed with the right information in making the new CEO selection. The next chapter provides general discussion including study implications and future recommendations.

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CHAPTER 5. DISCUSSION, IMPLICATIONS, RECOMMENDATIONS

Introduction

This research investigated the relationship between new CEO successor origins and the subsequent organizational performance of *Fortune* 500 companies. With the research findings presented, this concluding chapter gives the researcher the opportunity to discuss the research journey to the present and its' contributions to the literature.

A brief descriptive overview summarize the study, including problem, purpose, literature review, and methodological approach. The discussion in the subsequent pages focused on the relationship of the present study to the related bodies of knowledge and the paradox of organizational financial outcomes. The findings of this study presented and examined in light of the posited research question and the study hypothesis. Finally, the researcher describes possible organizational implications and provides recommendations for relevant future research efforts.

The Problem and Purpose

Over the past several decades, the theory of how new CEO successor origin influences subsequent organizational performance has been debated among scholars and other researchers (Shen & Cannella, 2002). However, while researchers have developed a substantial body of knowledge on the performance consequences of CEO successions, the majorities of these research findings were inconclusive or contradictory; most were constrained by various sampling limitations because they focused on small sample from

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individual and relatively small companies (Wasserman, 2003).

The present study was design to advance the research on performance consequences of CEO successions beyond previous research sampling limitations and to remove research gaps in what we know about the new CEO successor origins and post-succession financial performance. Through quantitative empirical research, this study explored the relationship between new CEO successor origins and subsequent performance of *Fortune* 500 companies.

Literature

The CEO succession literature generally conforms to one of three common research theoretical perspectives: causes of CEO succession, consequences of CEO succession, and shareholder wealth effects of CEO succession. The current study specifically focused on the theoretical perspectives pertaining to the consequences of CEO succession.

Methodology

The empirical evidence for this study came from financial data reported by *Fortune* 500 companies over the period from 2004 to 2007. Firms listed in the 2003 calendar year *Fortune* 500 companies that experienced single succession event during the period from 2003 through 2005 represented the final sample used in this study. The final sample for this study comprised of 56 *Fortune* 500 companies; each CEO successor type represented by 28 firms. Once the final sample for the study was determined (see Appendix C), the financial statement data for one year (Yr-1) prior to succession and for two consecutive years (Yr+1 & Yr+2) following succession were collected from the

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respective firm. The researcher presented the financial data mean value to normalize random fluctuations.

Accounting measures in the form of financial ratios, allowed for specific measure of organizational financial performance in three categories: profitability, leverage, and efficiency. The bases for selected financial ratios for this study include considerations in existing empirical studies, relationship to other variables in the current study, and determinations of relevancy to the current study. The statistical data analysis process produced seven best predictor variables, representing the three operational performance categories of profitability, leverage, and efficiency and subsequently provided the researcher the needed evidence to test the research hypothesis and to answer the research question.

Discussion

Given the current globalization and other sociopolitical environmental changes, the decision to buy or build new CEO successors represents an adaptive strategy that is very critical to attainment of organizational goals and the future course of the organization. Making a bad new CEO selection decision could not only be a source of embarrassment to the board of directors, it also could be a very costly decision to the organization both in the near term and in the long term (Vancil, 1987).

Building on the theories of leadership and organizational change, the researcher proposed that selection of an insider CEO successor or an outsider CEO successor would result in no significantly different post-succession organizational financial performance using Accounting-Based financial performance measures. This study compared pre-

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succession and post-succession financial data of 56 *Fortune* 500 companies, 28 each representing CEO-Type1 and CEO-Type2 firms, using applicable accounting based financial performance measures to gauge their relative economic health based on the new CEO successor origins.

The statistical data analysis employed in this study resulted in the development of seven best predictor variables in three commonly employed organizational performance categories; allowing the researcher to compare the performance outcomes of CEO-Type1 versus CEO-Type2 firms. The results provided evidence to answer the research question postulated in this study and to test the stated research hypothesis.

The specific details of the evidence provided by the seven best predictor variables are as follows. CEO-Type2 firms slightly outperformed CEO-Type1 firms in six of the seven best predictor variables; CEO-Type1 firms slightly outperformed CEO-Type2 firms only for Var23 or Long-Term Liabilities Percent (see Table 18).

Under the post-succession profitability category: CEO-Type2 firms achieved slightly better with return on assets or Var2 at 0.025 versus 0.017 for CEO-Type1 firms.

Under the post-succession leverage category: CEO-Type2 firms scored relatively better with current liabilities percent or Var6 at 0.279 versus 0.573 for CEO-Type1 firms. CEO-Type2 firms also achieved relatively better with current assets turnover or Var9 at 0.967 versus 0.661 for CEO-Type1 firms.

Under the post-succession efficiency category: CEO-Type2 firms achieved relatively better with total assets turnover or Var15 at 0.360 versus 0.264 for CEO-Type1 firms. CEO-Type2 firms scored slightly better with equity to revenue factor or Var16 at

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0.458 versus 0.436 for CEO-Type1 firms. CEO-Type2 firms also scored slightly better with return on equity or Var21 at 0.152 versus 0.147 for CEO-Type1 firms. Finally, CEO-Type1 firms scored relatively better with long-term liabilities percent or Var23 at 0.310 versus 0.560 for CEO-Type2 firms.

Findings of this study, like many similar prior studies, corroborated suggestions that Accounting-Based financial performance measures or economic performance outcomes can be effective in assessing organizational performance issues. However, given that the financial performance construct is multidimensional in nature, the use of one performance measure is always at the risk of excluding other relevant dimensions of the performance construct (Rowe & Morrow, 1999). Furthermore, the use of multiple performance measures could add the risk of erroneously combining or mixing unrelated performance constructs. Hence, each researcher must determine and be explicit with respect to the type of the financial performance measure that best addresses the research question (Rowe & Morrow, 1999).

For this study, the researcher selected the Accounting-Based financial performance construct, using the most relevant financial ratios or predictor variables. Theoretically, "…Accounting-Based measures are believed to assess a firm's short-term performance, reflect historical information, and retrospective in their temporal scope" (Rowe & Morrow, 1999, p. 59).

The results of this study may not drastically change previous research findings, or provide conclusive empirical evidence as to which of the two successor origins would make better new CEO successors. However, findings of this study clearly provide

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corroborating evidence, which suggests that new outsider CEO successors have demonstrated abilities, and are capable of moving the organization toward attainment of future financial goals. In other words, the results of this study indirectly clarify some of prior research ambiguities and confusion by providing evidence that new outsider CEO successors could perform at a level equal to or possibly better than new insider CEO successors in the first two years following the succession.

Implications

There are far more fundamental implications to the buy or build decisions in selecting new CEO successors than the economic performance outcomes. The boards of directors' decision to select their next new CEO successors from the inside or from the outside generally depend on several intervening factors. The most obvious factor is the circumstance surrounding the incumbent CEO departure. Other factors include whether or not robust succession planning was in place suggesting the possibility of an insider option; desire of the organizations' boards of directors based on the future direction of their organizations; finally, the market or the supply and demand placed on available candidates.

To ensure congruency of organizational intent and to assure the desired competencies, boards of directors need good information on new CEO successor candidates prior to making selection decisions. Insufficient or bad information could lead to the selection of inappropriate new CEO successor candidates. The consequences of poor CEO successor selection decision can be both costly and detrimental to post-succession economics outcomes.

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An important goal of many CEO succession studies is to understand the contexts or characteristics that are conducive to effective new CEO successors. However, the boards of directors' due diligence and effective governance practices may be the ultimate key to selecting the right new CEO successor that could enhance organizational performance. By establishing effective governance practices including the development of robust CEO succession planning, organizations can increase their chances of getting the right information for making the right new CEO successors selection decisions.

The researcher posts the following question to draw attention to the importance of robust succession planning as a foundation for effective executive succession: How could something that is clearly an inevitable event and the single most important requirement of any organization continue to receive minimal forward planning from so many organizations?

For example, when the CEO of Bank of America (a major *Fortune* 500 company) abruptly resigned late in 2009, the board of directors was plagued with criticism, because the board was less prepared for the sudden CEO departure. The board was lacking an effective CEO succession process, which could have facilitated finding the right new CEO successor (Behan, 2009). There was clearly a lap in due diligence regarding effective governance practices (Cornwall, 2001). As Cornwall (2001) noted, "…shareholders are getting too many surprises as a result of [board of directors'] ineffective leadership or sudden CEO termination that place organizational performance at risk" (p. 28). In this case, the absence of a comprehensive succession process clearly undermines the leadership due diligence or the detailed insight needed by the board of

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directors to make the right new CEO successor decisions quickly and effectively (Behan, 2009; Cornwall, 2001).

Clearly, an effective succession planning process is necessary to assure that the board of directors is equipped to select a new CEO successor in any situation including in an emergency, by providing timely information to choose the best qualified insider or outsider candidate effectively. In other words, post-succession firm performance is really the time test of the organizational leadership succession strategy (Schendel & Hofer, 1979).

This researcher concurs with many prior organizational researchers in their contentions that organizational performance should be viewed as a function of multifaceted environmental and sociopolitical factors. In other words, organizational financial performance expectations can be significantly influenced by other phenomena beside the new CEO successor origins, including current global market economy, current competition, current industry structure, and many other sociopolitical factors that are present in the organizational environment (Datta & Rajagopalan, 1998). While it has been said that performance is a time test of organizational leadership change, it can also be a good measure of how effectively firms are coping with the demands in their environments (Cannella & Lubatkin, 1993; Friedman & Singh, 1989; Goodstein & Boeker, 1991).

Costs of Recruitment From Outside

Implications of the costs attributable to recruiting new CEO successors from outside the organization have received only limited attention in the organization and

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management literature. In spite of the limited coverage in the literature, recruiting new CEO successors from outside the organization can be very costly. According to Tuna (2008), the median pay for outsider new CEOs was 65 percent more in 2007 than for comparable new CEOs hired from the inside.

Clearly, the labor market is unique for highly qualify CEO candidates; therefore, firms often must respond to the economic reality of supplies and demands for highly qualified outsider CEO candidates with premium pay (Ang, Lauterbach, & Vu, 2003). Firms must compete for the best available outsider CEO candidates for the job; "… the more competent is the new CEO, the higher is the net value-added to the firm" (Ang, et al., 2003, p. 31). Hence, with the right new outsider CEO successors, recruiting costs should be more than offset by the benefits received from the value added to firms (Ang, et al., 2003).

An important element in recruiting new CEO successors is getting the right information about the best candidate for the job. Particularly, getting the right information on highly qualified outsider CEO candidates can be costly; firms generally rely on the executive recruiting firms for help in recruiting the right outsider CEO candidates.

Unlike most highly qualified outsider CEO candidates, most highly qualified insider CEO candidates may value their appointment to the new CEO post more as a personal achievement rather than for the premium pay (Ang, et al., 2003). While insider CEO candidates may have less interest in premium packages, highly qualified outsider CEO candidate have often demanded and received costly executive compensation

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packages. As Lambertides (2009) suggested, most new outsider CEO successors are likely to do more to help firms improve performance than most new insider CEO successors.

Recommendations

There have been considerable research efforts in the past several decades to enhance understanding of the relationship between new CEO successor origins and subsequent organizational financial performance. However, research findings have consistently been short of reaching the desirable knowledge alignment among researchers (Cannella & Lubatkin, 1993; Dalton & Kesner, 1983; Zajac, 1990; Zajac & Westphal, 1996). As part of the quest to continue to learn more about this topic, future research should be directed toward other specific implications of new CEO successors origins not related to economic outcomes. As Friedman and Saul (1991) argued, "…economic performance outcomes should not be the only impetus for researching the consequences of CEO succession" (p. 620). Alternatively, replicating this study among organizations other than *Fortune* 500 companies could further legitimize the research results.

Furthermore, while the quantitative research method used in this study continues to be the prevailing paradigm in management and organizational studies, it is not without limitations. Fortunately, other alternative research methods or paradigms have emerged, including the qualitative research method. The qualitative research method presents opportunity for future researchers to probe more deeply into the current research findings.

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Conclusion

The results of the current study on new CEO successor origins and post-succession financial outcomes of *Fortune* 500 companies fill some of the existing research gaps. Clearly, this study shows that an insider or an outsider new CEO successor could continue to move the organization forward with minimal performance risk. However, to minimize post-succession performance risk, boards of directors must commit to due diligence on new CEO successor selection, evaluation, and succession planning and development decisions (Cornwall, 2001).

By recognizing many of the implications associated with new CEO successor origins, including robust succession process, boards of directors would be more effective in selecting the right new CEO successors. This study provides useful information for those leaders including boards of directors who are involved in new CEO successors' selection decisions.

Generally, stakeholders rely heavily upon CEOs to possess the acumen to develop the necessary strategic initiatives, which should enable attainment of the organizational financial performance objectives. As Shen & Cannella (2002) noted, stakeholders are most likely to view negatively new leaders that are unable to develop reliable and effective operational routines.

Furthermore, stakeholders depend upon boards of directors to be effective in carrying out their fiduciary duty of selecting the right new CEO successors who are capable of moving their organizations forward (Cornwall, 2001). However, there are quantifiable and non-quantifiable aspects of leadership, which are key factors to the

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success of organizations. For example, key successor attributes such as age, experience, industry of origin, specialization, education, cultural background, just to name a few, could affect new outsider CEOs' ability to consolidate or to form an effective leadership (Helmich,1977; Shen & Cannella, 2002). Therefore, to mitigate the potential risk that may be present in selecting the new CEO successors and to alleviate costly or disruptive short CEO tenure, boards of directors need to maintain an effective succession process, which would allow them to harness all available information to facilitate the selection of the right insider or outsider new CEO successors.

The evidence provided in this study suggests that insider CEO candidates should not be more favorable in comparison to external CEO candidates. In other words, both the insider and the outsider new CEO successor candidates are equally capable of moving the organization forward financially. This new evidence-based information should allow boards of directors to focus on other important attributes of the selection process, hence moving the new CEO successor selection initiatives in the right direction.

It is important to point out that this research benefitted from the rapid advancements in information technologies in the past few years by making access to the organizational empirical financial data more accessible; and allowing this researcher and others to conduct a more rigorous study on CEO succession. Many past studies on CEO succession and organizational performance have been faced with various data collection impediments. More particularly, many research efforts have been hampered by the inability to collect relevant empirical financial data. Such constraints have lessened many researchers' ability to conduct more rigorous and constructive studies on the

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performance consequence of CEO succession (Helmich, 2001). Therefore, results from many of these CEO succession studies have been mostly contradictory or misleading; they are clearly inadequate to support or guide the new CEO successor selection decisions; this was one of the main reasons for conducting the present study.

This researcher as well as many prominent organization and management researchers firmly believe that entrepreneurial financial success is a multidimensional construct, which has often been measured using accounting based measures (Hannan & Freeman, 1984; Shen & Cannella, 2002; Wasserman, 2003). The present study specifically focused on accounting based indicators as the basis for determining the linkage between new CEOs successor origins and the subsequent organizational economics outcomes of the *Fortune* 500 companies.

Finally, while the evidence provided in this study clearly supports the stated study hypothesis and answers the research question, this researcher still believes in the sentiment that "there is little that we know convincingly…and even more that we have not yet studied" (Kesner & Sebora, 1994, p. 327). This researcher believes that this study does add new knowledge and advances what we currently know about the performance consequences of new CEO successor origins.

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APPENDIX A. LIST OF 2003 *FORTUNE* 500 COMPANIES (*N*)

Company Name	Rank	Company Name	Rank
Wal-Mart Stores	1	Walgreen	45
General Motors	2	Wells Fargo	46
Exxon Mobil	3	Microsoft	47
Ford Motor	4	Merrill Lynch	48
General Electric	5	United Technologies	49
Citigroup	6	ConAgra Foods	50
ChevronTexaco	7	Dow Chemical	51
Intl. Business Machines	8	Marathon Oil	52
American Intl. Group	9	Delphi	53
Verizon Communications	10	Sprint	54
Altria Group	11	Valero Energy	55
ConocoPhillips	12	Lockheed Martin	56
Home Depot	13	Prudential Financial	57
Hewlett-Packard	14	Intel	58
Boeing	15	Motorola	59
Fannie Mae	16	Lowe's	60
Merck	17	Walt Disney	61
Kroger	18	PepsiCo	62
Cardinal Health	19	UnitedHealth Group	63
McKesson	20	International Paper	64
State Farm Insurance Cos	21	New York Life Insurance	65
AT&T	22	Viacom	66
Bank of America Corp.	23	DuPont	67
AmerisourceBergen	24	CVS	68
Target	25	American Express	69
J.P. Morgan Chase & Co.	26	Wachovia Corp.	70
SBC Communications	27	Archer Daniels Midland	71
Berkshire Hathaway	28	Tyson Foods	72
Time Warner	29	Sysco	73
Sears Roebuck	30	Georgia-Pacific	74
Procter & Gamble	31	Goldman Sachs Group	75
Freddie Mac	32	Ingram Micro	76
Costco Wholesale	33	BellSouth	77
Johnson & Johnson	34	Honeywell Intl.	78
Albertson's	35	Bank One Corp.	79
Dell	36	Electronic Data Systems	80
Pfizer	37	Supervalu	81
MetLife	38	Alcoa	82
Kmart Holding	39	FedEx	83
Morgan Stanley	40	Mass. Mutual Life Ins.	84
Safeway	41	Caterpillar	85

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J.C. Penney	42
United Parcel Service	43
Allstate	44
TIAA-CREF	89
HCA	90
Best Buy	91
Coca-Cola	92
AutoNation	93
Washington Mutual	94
Cisco Systems	95
Weyerhaeuser	96
Visteon	97
Bristol-Myers Squibb	98
Northrop Grumman	99
Abbott Laboratories	100
Sara Lee	101
Fleming	102
WellPoint Health Networks	103
AMR	104
Raytheon	105
Pharmacia	106
Loews	107
Coca-Cola Enterprises	108
Lehman Brothers Hldgs.	109
3M	110
Nationwide	111
Publix Super Markets	112
Northwestern Mutual	113
Hartford Financial Services	114
FleetBoston Financial	115
Xerox	116
Tech Data	117
Duke Energy	118
AT&T Wireless Services	119
American Electric Power	120
Qwest Communications	121
Federated Dept. Stores	122
U.S. Bancorp	123
McDonald's	124
Rite Aid	125
Exelon	126
Household International	127
Wyeth	128
Liberty Mutual Ins. Group	129
Gap	130
Lear	131
Johnson Controls	86
Cigna	87
Aetna	88
TXU	134
Deere	135
Tenet Healthcare	136
General Dynamics	137
Emerson Electric	138
Goodyear Tire & Rubber	139
PG&E Corp.	140
Lucent Technologies	141
Anheuser-Busch	142
Kimberly-Clark	143
May Dept. Stores	144
Delta Air Lines	145
Wellpoint	146
Express Scripts	147
AdvancePCS	148
Winn-Dixie Stores	149
Eastman Kodak	150
Circuit City Stores	151
El Paso	152
Halliburton	153
Sunoco	154
Sun Microsystems	155
Union Pacific	156
Comcast	157
Solectron	158
FirstEnergy	159
Cinergy	160
TJX	161
Amerada Hess	162
Edison International	163
Reliant Energy	164
Staples	165
Office Depot	166
Computer Sciences	167
Toys `R` Us	168
Humana	169
PacifiCare Health Sys.	170
Waste Management	171
Eli Lilly	172
Whirlpool	173
Textron	174
Marriott International	175
Manpower	176

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Company	Rank
UAL	132
Cendant	133
MBNA	179
Xcel Energy	180
AES	181
Dana	182
AFLAC	183
Dominion Resources	184
Health Net	185
Fluor	186
Schering-Plough	187
Nike	188
Illinois Tool Works	189
Oracle	190
Capital One Financial	191
UnumProvident	192
Northwest Airlines	193
H.J. Heinz	194
Masco	195
Williams	196
Progressive	197
Colgate-Palmolive	198
USAA	199
Pepsi Bottling	200
Dean Foods	201
Limited Brands	202
Chubb	203
Kohl's	204
Burlington No. Santa Fe	205
Avnet	206
St. Paul Travelers Cos.	207
John Hancock Financial Svcs.	208
Countrywide Financial	209
Principal Financial	210
Public Service Enterprise Group	211
Aon	212
Aramark	213
Sanmina-SCI	214
National City Corp.	215
Nextel Communications	216
Consolidated Edison	217
Gillette	218
Clear Channel Communications	219
Continental Airlines	220
Plains All Amer. Pipeline	221
Baxter International	222
Texas Instruments	223

Company	Rank
Southern	177
Marsh & McLennan	178
Entergy	224
Kellogg	225
FPL Group	226
Genuine Parts	227
Progress Energy	228
Dillard's	229
Smurfit-Stone Container	230
CSX	231
Guardian Life of America	232
PPG Industries	233
Alltel	234
General Mills	235
CenterPoint Energy	236
CHS	237
American Standard	238
Ashland	239
Yum Brands	240
Centex	241
First Data	242
Farmland Industries	243
United Auto Group	244
Arrow Electronics	245
Calpine	246
Omnicom Group	247
SunTrust Banks	248
MeadWestvaco	249
Pulte Homes	250
Newell Rubbermaid	251
Occidental Petroleum	252
Sonic Automotive	253
OfficeMax	254
Smithfield Foods	255
Lennar	256
Paccar	257
Eaton	258
Mirant	259
Safeco	260
Automatic Data Proc.	261
US Airways Group	262
Tesoro	263
United States Steel	264
Bear Stearns	265
ArvinMeritor	266
Caremark Rx	267
Crown Holdings	268

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Premcor	269	Eastman Chemical	315
DTE Energy	270	Unocal	316
D.R. Horton	271	CIT Group	317
CMS Energy	272	Barnes & Noble	318
NiSource	273	IAC/Interactive	319
Navistar International	274	Baker Hughes	320
Gannett	275	Sherwin-Williams	321
Medtronic	276	VF	322
PNC Financial Services	277	American Family Ins. Grp.	323
Fifth Third Bancorp	278	Praxair	324
Norfolk Southern	279	WellChoice	325
Avon Products	280	Fidelity National Financial	326
Reynolds American	281	Applied Materials	327
Interpublic Group	282	SPX	328
Parker Hannifin	283	Cox Communications	329
Conseco	284	Northeast Utilities	330
KeyCorp	285	OM Group	331
Campbell Soup	286	KB Home	332
BB&T Corp.	287	ITT Industries	333
Science Applications Intl.	288	Oxford Health Plans	334
Dollar General	289	Avaya	335
KeySpan	290	Dynegy	336
Sempra Energy	291	Mattel	337
Agilent Technologies	292	Owens Corning	338
Nordstrom	293	Ikon Office Solutions	339
Saks	294	State St. Corp.	340
BJ's Wholesale Club	295	Echostar Communications	341
Cummins	296	Nucor	342
Land O'Lakes	297	McGraw-Hill	343
Owens-Illinois	298	Maytag	344
Bank of New York Co.	299	Ryder System	345
Apple Computer	300	OfficeMax	346
Rohm & Haas	301	CNF	347
Thrivent Financial for Lutherans	302	R.R. Donnelley & Sons	348
Unisys	303	Estee Lauder	349
NCR	304	Mellon Financial Corp.	350
Amgen	305	First American Corp.	351
Southwest Airlines	306	Constellation Energy	352
Allied Waste Industries	307	Temple-Inland	353
EMC	308	Caesars Entertainment	354
PPL	309	W.W. Grainger	355
Federal-Mogul	310	Lincoln National	356
Air Products & Chem.	311	Danaher	357
Tribune	312	RadioShack	358
Fortune Brands	313	Jacobs Engineering Grp.	359
	314	Asbury Automotive Group	360

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Company	Rank
Mohawk Industries	361
Charter Communications	362
Foot Locker	363
Charles Schwab	364
Autoliv	365
Performance Food Group	366
Longs Drug Stores	367
Pitney Bowes	368
Devon Energy	369
Black & Decker	370
Dole Food	371
Darden Restaurants	372
Lexmark International	373
Mutual of Omaha Ins.	374
Jones Apparel Group	375
AK Steel Holding	376
Pepco Holdings	377
Kelly Services	378
HealthSouth	379
Leggett & Platt	380
CDW	381
Dover	382
Group 1 Automotive	383
Avery Dennison	384
Goodrich	385
Harrah's Entertainment	386
Gateway	387
Family Dollar Stores	388
Levi Strauss	389
Hershey Foods	390
Quest Diagnostics	391
Harley-Davidson	392
Providian Financial	393
Clorox	394
Brink's	395
Becton Dickinson	396
MGM Mirage	397
L-3 Communications	398
Energy East	399
Cablevision Systems	400
Graybar Electric	401
Murphy Oil	402
NTL Europe	403
Emcor Group	404
Owens & Minor	405
Pathmark Stores	406
Amazon.Com	407
Hormel Foods	408
Rockwell Automation	409
Nash Finch	410
Collins & Aikman	411
Starwood Hotels & Rsrts.	412
Big Lots	413
Anadarko Petroleum	414
Ball	415
Hilton Hotels	416
York International	417
Ameren	418
Pacific Life	419
Regions Financial	420
Maxtor	421
Molson Coors Brewing	422
Engelhard	423
American Financial Grp.	424
Golden West Financial	425
Kerr-McGee	426
Wisconsin Energy	427
Phelps Dodge	428
Liz Claiborne	429
Brunswick	430
United Stationers	431
Peter Kiewit Sons'	432
Comerica	433
Host Marriott	434
Washington Group Intl.	435
Roundy's	436
ServiceMaster	437
Enterprise Products	438
Coventry Health Care	439
Bethlehem Steel	440
Jabil Circuit	441
Triad Hospitals	442
Interstate Bakeries	443
Ross Stores	444
Auto-Owners Insurance	445
Borders Group	446
Spartan Stores	447
Equity Office Properties	448
Encompass Services	449
American Axle & Mfg.	450
Jefferson-Pilot	451
USG	452

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Company	Rank
Tenneco Automotive	453
Erie Insurance Group	454
Corning	455
Allmerica Financial	456
Ecolab	457
Airborne	458
Cooper Tire & Rubber	459
SouthTrust Corp.	460
Wesco International	461
H&R Block	462
Kindred Healthcare	463
C.H. Robinson Worldwide	464
Starbucks	465
Advance Auto Parts	466
Lyondell Chemical	467
Universal Health Svcs.	468
ShopKo Stores	469
PepsiAmericas	470
Guidant	471
Fisher Scientific Intl.	472
SLM	473
Yellow Roadway	474
Sealed Air	475
Roadway	476
Aquila	477
Armstrong Holdings	478
Shaw Group	479
Smith International	480
Level 3 Communications	481
NVR	482
Reebok International	483
OGE Energy	484
Steelcase	485
New York Times	486
Hughes Supply	487
Affiliated Computer Svcs.	488
Qualcomm	489
Ace Hardware	490
Lennox International	491
AmSouth Bancorp.	492
Stryker	493
Sierra Pacific Resources	494
Telephone & Data Sys.	495
Allegheny Energy	496
Computer Assoc. Intl.	497
Burlington Resources	497
SCANA	499
Neiman Marcus	500

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APPENDIX B. INITIAL STUDY SAMPLE (*n*)

Company Name	Rank	Company Name	Rank
Citigroup	6	TXU	134
American Intl. Group	9	Tenet Healthcare	136
Boeing	15	Express Scripts	147
Kroger	18	Winn-Dixie Stores	149
Target	25	El Paso	152
Dell	36	FirstEnergy	159
Kmart Holding	39	Reliant Energy	164
J.C. Penney	42	Waste Management	171
Dow Chemical	51	Whirlpool	173
Lockheed Martin	56	Marsh & McLennan	178
Motorola	59	Kellogg	225
Lowe's	60	Progress Energy	228
International Paper	64	Centex	241
Caterpillar	85	Pulte Homes	250
Coca-Cola	92	Automatic Data Proc.	261
Visteon	97	United States Steel	264
Sara Lee	101	ArvinMeritor	266
AMR	104	Baker Hughes	320
Loews	107	Applied Materials	327
Coca-Cola Enterprises	108	SPX	328
Duke Energy	118	Northeast Utilities	330
American Electric Power	120	ITT Industries	333
Qwest Communications	121	State St. Corp.	340
McDonald's	124	CNF	347
Rite Aid	125	R.R. Donnelley & Sons	348
MBNA	179	Estee Lauder	349
Dana	182	Federal-Mogul	310
Schering-Plough	187	RadioShack	358
Nike	188	Charter Communications	362
UnumProvident	192	Charles Schwab	364
Northwest Airlines	193	Performance Food Group	366
Aramark	213	Darden Restaurants	372
Continental Airlines	220	Mutual of Omaha Ins.	374
Baxter International	222	AK Steel Holding	376
Texas Instruments	223	Dover	382
Premcor	269	Goodrich	385
CMS Energy	272	Gateway	387
Reynolds American	281	Quest Diagnostics	391
Interpublic Group	282	Clorox	394
Conseco	284	NTL Europe	403

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Science Applications Intl.	288	Rockwell Automation	409
Agilent Technologies	292	Collins & Aikman	411
Unisys	303	Anadarko Petroleum	414
NCR	304	York International	417
Southwest Airlines	306	Ameren	418
Allmerica Financial	456	Maxtor	421
Ecolab	457	Kerr-McGee	426
Kindred Healthcare	463	Wisconsin Energy	427
Starbucks	465	Roundy's	436
PepsiAmericas	470	Enterprise Products	438
SLM	473	Coventry Health Care	439
Hughes Supply	487	Auto-Owners Insurance	445
Qualcomm	489	Jefferson-Pilot	451
Stryker	493	May Dept. Stores	144

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APPENDIX C. FINAL STUDY SAMPLE (*n*)

Company Name	Origin	Company Name	Origin
Citigroup	I	Reynolds American	O
American Intl. Group	O	Interpublic Group	I
Kroger	I	Conseco	O
Target	O	Agilent Technologies	O
Dell	I	Unisys	I
Kmart Holding	O	NCR	O
J.C. Penney	I	Southwest Airlines	I
Dow Chemical	I	Tenet Healthcare	I
Lockheed Martin	I	Express Scripts	I
Motorola	O	FirstEnergy	I
Lowe's	I	Reliant Energy	I
International Paper	O	Waste Management	O
Caterpillar	O	Whirlpool	I
Visteon	O	Marsh & McLennan	O
Sara Lee	I	Kellogg	O
AMR	O	Progress Energy	I
Duke Energy	I	Centex	O
American Electric Power	I	Pulte Homes	I
Qwest Communications	I	Automatic Data Proc.	O
McDonald's	I	United States Steel	O
Rite Aid	I	ArvinMeritor	I
Dana	O	Baker Hughes	I
Schering-Plough	O	SPX	O
Nike	I	Estee Lauder	O
Continental Airlines	I	Charter Communications	O
Baxter International	O	AK Steel Holding	O
Texas Instruments	I	Clorox	O
CMS Energy	O	Anadarko Petroleum	O

Note: (1) I = Insider CEO O = Outsider CEO.

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