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Macro Roundup Article

Headline: The Market for CEOs: Evidence from Private Equity

Article Link: https://www.nber.org/papers/w30899

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Tweet: .@KaplAnalysis examines large US companies purchased in LBO transactions and finds that 71% of the companies hired new CEOs, and more than 75% of these were external hires. He concludes that "firm-specific human capital is relatively unimportant."

Summary: We study the market for CEOs among larger U.S. companies (enterprise value greater than $1 billion) purchased by private equity firms between 2010 and 2016. More than 70% of those companies hire new CEOs. Of these, more than 75% are external hires with 67% being complete outsiders. These results are strikingly different from studies that look at public companies, who find that 72% of new CEOs are internal promotions while 80% are internal promotions, former executives, or board members. The most recent experience of 70% of the outside CEOs was at a public company with 32% at an S&P 500 company. Almost 50% of the external hires have some previous experience at an S&P 500 company. The median and average buyout in our sample earned roughly 2.5 times on its equity investment. This is interesting given that the public-to-private deals in our sample were not particularly poor performers before they were bought. Because private equity investors are paid strongly for performance (through their carried interest or profit share of 20% on most funds), private equity investors have strong incentives not to provide rents to their CEOs. The pay of CEOs in private-equity funded companies, therefore, should be relatively rent-free. Using the performance of the buyouts and survey evidence on buyout equity incentives, we estimate the compensation buyout CEOs earn and find that the magnitude is much higher than that for similar-sized public companies and comparable to or slightly lower than that of S&P 500 CEOs. The results that top executives move from public companies to private equity funded companies at competitive compensation levels suggest that the broader market for CEOs is quite active and that, at least for private equity-funded companies, firm-specific human capital is relatively unimportant.

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