

LAST DANCE OR SECOND CHANCE? FIRM PERFORMANCE, CEO CAREER HORIZON, AND THE SEPARATION OF BOARD LEADERSHIP ROLES

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In recent years, many firms have chosen to separate their CEO and board chair positions. Prior research has demonstrated that there are three forms that a CEO–board chair separation can take: apprentice, departure, and demotion. In this paper, we examine the antecedents of these three types. Our results show that the three types of separation each have different profiles in terms of the prior performance of the firm, the independence of the board, and the career horizon of the incumbent CEO. The findings in this paper provide unique insights into the factors that drive boards' structural choices. As questions about board leadership structure become more nuanced and more relevant in both scholarship and practice, a full understanding of these factors will only become more important. Copyright © 2013 John Wiley & Sons, Ltd.

INTRODUCTION

Between 2001 and 2011, the percentage of S&P 500 firms with a separate board leadership structure (the CEO and board chair are separate individuals) grew from 26 to 41 percent (Spencer Stuart, 2011). This shift in common corporate governance practice has turned the typically static phenomenon of board leadership structure (Rechner and Dalton, 1991) into a dynamic strategic concern. The increase in CEO–board chair separations has occurred alongside governance experts' insistence that the separate leadership structure represents best practice for boards of directors

(MacAvoy and Millstein, 2004; Monks and Minow, 2008). Yet, despite decades of scholarship on the issue of board leadership structure (Dalton *et al.*, 1998; Finkelstein and D'Aveni, 1994), scholarship on the determinants of CEO–board chair separation has been relatively sparse.

One area of research that has garnered some attention, albeit with little consensus emerging, is the effect of firm performance on boards' decision to separate their top leadership roles. Some have argued that poor past performance will precipitate a separation as the board attempts to correct a perceived agency problem (Harrison *et al.*, 1988; Hermalin and Weisbach, 1998). Empirical assessment of this hypothesis has, however, failed to produce much evidence that boards respond to firm performance with CEO–board chair separations (Daily and Dalton, 1995; Iyengar and Zampelli, 2009). In this paper, we suggest that this lack of evidence could be due to the fact that not all CEO–board chair separations are the same.

Keywords: board leadership; CEO succession; CEO career horizon; board composition; corporate governance
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CEO–board chair separation is a unique subject of study because it can occur as one of three types. Two of the types, demotion and departure separations, can be thought of as “corrections,” in which the individual formerly serving as CEO/chair loses just the chair position or both the CEO and chair positions, respectively (Krause and Semadeni, 2013). In contrast, apprentice separations are more of an affirmation of the CEO/chair’s performance, in which the individual formerly serving as CEO/chair is retained as board chair after he or she has left the CEO position (Krause and Semadeni, 2013; Quigley and Hambrick, 2012). Because the separation types have different profiles, we expect that they would be employed under different circumstances. Based on agency theory (Fama and Jensen, 1983), we argue that departure and demotion separations reflect a greater concern with governance change than does an apprentice separation, which is primarily a mechanism for orderly succession (Vancil, 1987). As such, we hypothesize that departure and demotion separations will follow poorer performance than apprentice separations, primarily at firms with independent boards.

Although performance and board independence distinguish the correction separations of departure and demotion from the orderly apprentice separation, they do not explain the occurrence of each type of separation individually. To do this, we draw on upper echelons theory, employing a construct often included in CEO succession and other corporate governance studies, but almost always as just a control variable: the age of the CEO. Specifically, we examine the CEO’s career horizon, or the amount of time the CEO has until retirement (Matta and Beamish, 2008; McClelland *et al.*, 2012). This construct is particularly well suited to the study of CEO–board chair separation because retirement plays such a large role in the CEO succession process (Finkelstein, Hambrick, and Cannella, 2009: 168), and yet it has received relatively little attention. Based on both agency and upper echelons logic, we hypothesize that a CEO’s career horizon determines the firm’s choice of separation type, such that CEOs with short horizons will experience apprentice separations, CEOs with long horizons will experience demotion separations, and CEOs with moderate horizons will experience departure separations. We test our theory on a sample of 352 CEO–board chair separation events at S&P 1500 firms between 2003 and 2006. The results provide strong support for our theory.

This research contributes to both the board leadership structure literature and the CEO succession literature, and also provides important insights for practice. Ours is the first study to examine the factors that cause firms to select one type of CEO–board chair separation over another. We extend theory by showing how CEO career horizon, firm performance, and board independence influence board decision making. In addition, our findings also build knowledge about the CEO succession process by illuminating the factors that determine whether a CEO is removed from a firm or kept in place under close supervision. According to our results, how a firm responds to performance problems depends on the incumbent CEO’s career horizon. This finding is a substantial contribution to both theory and practice because CEO age, once an important component of upper echelons theory and today a common control variable, has received scant attention as a variable of interest to either scholars or firms, especially when compared to the construct of CEO tenure (Miller, 1991; Shen and Cannella, 2002). We show fairly conclusively that a CEO’s career horizon has a significant impact on how that CEO is treated in the event of a CEO–board chair separation.

THEORY AND HYPOTHESES

Firm performance as a predictor of board leadership structure

Corporate governance scholars have been researching board leadership structure—whether or not a firm’s CEO also serves as board chairman—for nearly 40 years (Berg and Smith, 1978; Finkelstein and D’Aveni, 1994; Rechner and Dalton, 1991). Dalton *et al.* (1998) identified the fundamental theoretical divide on the issue: agency theory’s recommendation of independence contrasted with stewardship theory’s recommendation of empowerment. According to most agency theorists, the CEO and board chair roles should be separated because the CEO acting as his or her own monitor creates a conflict of interest (Jensen, 1993; Lorsch and MacIver, 1989). In contrast, stewardship theorists contend that, in many situations, a combined leadership structure that empowers the CEO will actually promote good governance and good performance (Dalton and Dalton, 2005; Donaldson and Davis, 1991). After two decades

those problems by keeping the former CEO in a position of power over the incoming CEO (Daily and Dalton, 1997; Quigley and Hambrick, 2012). The apprentice separation commonly manifests as part of an orderly succession event (Brickley *et al.*, 1997; Vancil, 1987), typically involving the promotion of an heir apparent (Cannella and Shen, 2001; Zhang and Rajagopalan, 2004).

In many ways, an apprentice separation validates the tenure and performance of the outgoing CEO, as it indicates the board's continued desire for that individual's involvement in the organization. Relay successions have generally been considered a sign that the board is confident in the firm's present direction, and investors have been shown to agree to the extent that previous firm performance was positive (Shen and Cannella, 2003). Zhang and Rajagopalan (2004) found that firms were more likely to engage in relay successions the better firm performance was prior to the succession event. These results are intuitive, as poor performance constitutes a questionable foundation for the board to express a vote of confidence in the firm's strategic direction through a relay succession. As such, we do not expect apprentice separations to follow poor performance, and we believe that this distinction explains why prior research has yet to find strong evidence of a performance–separation link.

In sharp contrast, we expect the circumstances surrounding departure and demotion separations to be quite different. Whereas an apprentice separation suggests a desire for continuity and smooth succession, departure and demotion separations create a disruption and a deviation from the status quo. Whether the board is replacing the CEO/chair with two individuals (departure), or simply appointing a separate chair to oversee the current CEO (demotion), these separations send a signal that the board desires some sort of change in the firm's leadership. In either form of separation, the board clearly believes that an independent board chair is warranted.

According to agency theory, the fundamental role of the board is as a monitor of firm management (Fama and Jensen, 1983; Zajac and Westphal, 1994), and one of the most important aspects of this role is choosing the appropriate leadership structure (Finkelstein and D'Aveni, 1994). We anticipate that firms will separate their CEO and board chair roles following poor performance, as theory suggests (Linck *et al.*, 2008), but will do so

with either the demotion or departure separation types, not with the apprentice separation. Choosing either a departure or demotion separation indicates a desire for change, similar to a CEO succession in the wake of poor firm performance. Choosing one of these forms over an apprentice separation indicates that the board desires change, rather than continuity, and if the board perceives an agency conflict to be the source of the poor performance, the board will likely desire a more truly independent chair to oversee the CEO. Consistent with this reasoning, recent research has shown that boards devote greater attention to their monitoring duties when performance is poor (Tugge *et al.*, 2010).

As a result, we expect that among boards separating the CEO and board chair positions, those experiencing poor performance will opt for the departure or demotion separation type, and not the apprentice type.

Hypothesis 1a: Among firms undergoing a CEO–board chair separation, poor performance increases the likelihood of departure separations.

Hypothesis 1b: Among firms undergoing a CEO–board chair separation, poor performance increases the likelihood of demotion separations.

We do not, however, propose that boards will universally choose departure and demotion separations, as opposed to apprentice separations, when performance is low. Some boards are more responsive to performance issues than others. Consistent with agency theory, we argue that board independence—the percentage of directors that are independent and not inside or affiliated directors (Dalton *et al.*, 1998)—will increase a board's responsiveness to poor performance. Hermalin and Weisbach (1998) suggested that the effect of poor performance on CEO turnover would be stronger to the extent that boards were independent, and empirical evidence has supported this claim (Boeker, 1992; Weisbach, 1988).

Consistent with prior research in the agency theory tradition (Baysinger and Hoskisson, 1990; Finkelstein and D'Aveni, 1994; Johnson *et al.*, 1996), we assume that independent directors are more vigilant monitors of managerial behavior and less tolerant of agency problems than are affiliated or inside directors (Ellstrand *et al.*, 2002).

As such, board independence should strengthen the board's reaction to poor performance, and thus increase the likelihood that demotion and departure separations will follow poorer performance than will apprentice separations.

Hypothesis 2a: The effect of poor performance on the likelihood of departure separations becomes stronger as board independence increases.

Hypothesis 2b: The effect of poor performance on the likelihood of demotion separations becomes stronger as board independence increases.

It is important to draw a clear distinction between Finkelstein and D'Aveni's (1994) findings about board independence and the theory we are presenting. As one of the foundational works on board leadership structure, their study provides the theoretical and empirical basis for expecting board independence to negatively impact CEO–board chair separation. This tradeoff between independence of the board chair and independence of the other directors has received significant empirical validation through the years (Iyengar and Zampelli, 2009; Linck *et al.*, 2008; Sanders and Carpenter, 1998).¹ Our theory in no way conflicts with this very robust finding. Instead, we are hypothesizing that among firms choosing to separate the CEO and board chair roles, those firms experiencing poor performance will be more likely to opt for the departure or demotion separation rather than the apprentice separation to the extent that their boards are independent.

CEO career horizon

CEO career horizon and risk aversion

While poor performance can and has been used as a signal of agency problems, it is by no means the only available indicator of a deviation between the interests of the CEO and the interests

of shareholders. In the following pages, we join insights from upper echelons theory (Hambrick and Mason, 1984) with the previously mentioned work in agency theory to discuss yet another factor that impacts firms' choice of CEO–board chair separation type: CEO career horizon.

CEO career horizon is the amount of time remaining until a CEO reaches retirement age (Matta and Beamish, 2008). CEO age as a concept has an unusual history in governance research. It is present in many studies examining board-level and CEO-level variables (e.g., Zhang, 2006; Zhang and Wiersema, 2009), but its inclusion in analytical models is typically accompanied by the phrase, "We controlled for CEO age in our model ..." Few studies have systematically and theoretically explored the effect of CEO age on firm outcomes. We intend to contribute to this short, but important, research stream by showing how the age of a sitting CEO predicts which of the three possible types of CEO–board chair separation a board will choose if separation is their goal.

The reason we discuss age in terms of CEO career horizon is that the relevant attribute of the CEO's age, as it pertains to CEO–board chair separation, is not how long the CEO has been alive, but how many years the board can expect the CEO to remain at the firm (Antia *et al.*, 2010). The theory behind career horizons, which developed from upper echelons theory, suggests that CEOs' priorities and incentives will change as they draw closer to retirement (Brickley *et al.*, 1999), with older CEOs being more conservative and risk averse (Barker and Mueller, 2002; Dechow and Sloan, 1991). Hambrick and Mason (1984: 198) first made this point in their groundbreaking work on upper echelons theory:

There are three possible explanations for the apparent conservative stance of older executives. The first is that older executives may have less physical and mental stamina (Child, 1972) or may be less able to grasp new ideas and learn new behaviors ... A second explanation is that older executives have greater psychological commitment to the organizational status quo ... Third, older executives may be at a point in their lives at which financial security and career security are important.

¹ In addition to the studies cited, we conducted our own analysis on our sample of CEO–board chair separations and a control group of CEO change events, and found that board independence significantly reduced the likelihood that the firm separated the CEO and board chair roles, further corroborating Finkelstein and D'Aveni's (1994) results.

These proposed rationales, and primarily the last one, provided the theoretical foundation for what has become the study of CEO career horizon.

Most of the research in this area has focused on the impact career horizon has on firm outcomes. Barker and Mueller (2002) directly tested Hambrick and Mason's (1984) proposition that older executives are more risk averse in their study looking at the effects of CEO characteristics on research and development (R&D) spending. Since R&D spending inherently involves risk, Barker and Mueller (2002) argued that older CEOs should devote fewer funds to R&D than would younger CEOs. As the authors note, "Given that older CEOs may have only a few years before retirement, the pay-off from R&D spending may not personally benefit them" (Barker and Mueller, 2002: 785). The results of their study strongly supported this intuition.

Matta and Beamish (2008), while not grounding their work in upper echelons theory, built on the assumption that "an implication of short career horizon of CEOs is a growing aversion to risk aimed at preserving success" in examining the effect of CEO career horizon on international acquisitions. Citing earlier research establishing that older CEOs face shorter decision horizons (Gray and Cannella, 1997), they hypothesize that CEOs with longer career horizons will be more likely to engage in international acquisitions, as these are generally perceived as being very risky (Carpenter *et al.*, 2003; Shrader *et al.*, 2000). Not only did Matta and Beamish's (2008) results support their intuition that older executives engaged in fewer international acquisitions, their results also indicated that stock-based incentives were less effective at promoting CEO risk taking among older CEOs. Along with a list of related studies in multiple disciplines (Dechow and Sloan, 1991; McClelland *et al.*, 2012), Matta and Beamish's findings strongly suggest an inverse relationship between CEO career horizon and risk aversion.

The risk aversion of older CEOs should then have a direct impact on CEO–board chair separation. As executives' decision horizons shorten, they adopt a short-term orientation that deviates more and more from the long-term orientation of shareholders (Antia *et al.*, 2010). Boards, then, must factor a widening agency conflict into their decisions about how to separate the CEO and board chair positions. We propose that boards' choice about which type of separation is best for

their firm will hinge on two questions. We have already identified the first question, which is "Is there a performance problem that needs to be corrected?" The second question is "If so, can a correction be achieved without removing the current CEO?"

Is there a performance problem?

The first question, as discussed above, helps the board determine whether an apprentice separation or one of the two problem-correcting separations (i.e., departure or demotion) is best for the firm. An apprentice separation is a common element of a relay CEO succession (Quigley and Hambrick, 2012; Vancil, 1987), and as such not only tends to follow higher performance (Zhang and Rajagopalan, 2004) but also validates the outgoing CEO's tenure. Such a separation is a clear signal that the board is interested in continuity, not in change. As board chair, the outgoing CEO will still wield considerable power and influence within the organization and over the new CEO (Quigley and Hambrick, 2012). A board choosing to implement an apprentice separation is making the conscious decision to maintain the status quo. As Quigley and Hambrick (2012: 835, emphasis in original) observed: "Lingering predecessors can be expected to favor strategies and policies *they* put in place; now in positions of control over their replacements, predecessors who stay on as board chairs... may exert implicit or explicit constraint on any contemplated changes".

A board seeking to maintain continuity of leadership and preserve the status quo would, therefore, select an apprentice separation from among the three types (Daily and Dalton, 1997). In addition, preservation of the status quo is far more likely to occur with a seasoned veteran as the imposing board chair and former CEO than with a young upstart (Hambrick and Mason, 1984). Moreover, it stretches the limits of imagination to conceive of a reason a board would remove a young CEO from his or her position if preservation of the status quo was the board's goal. The apprentice separation is typically the beginning of an outgoing CEO's planned retirement. As Shen and Cannella (2002: 724) note, CEOs who relinquish their title at an advanced age but remain board chair for a few years "can hardly be treated as dismissed because it is unreasonable to keep a dismissed CEO as the chairman of the board,

or even as a director." Therefore, if the answer to the first important CEO–board chair separation question—Is there a performance problem?—is "no," and the board still desires a separate board leadership structure, it is because of a desire for continuity and commitment to the status quo. To this end, the board will engage in an apprentice separation for older, rather than younger, CEOs.

Can we avoid a CEO succession?

But what if the answer to the first question—Is there a performance problem?—is "yes"? Then, the board must select either a departure or a demotion separation, in which case the second question becomes relevant: Can a correction be achieved without removing the current CEO? If the board chooses a demotion separation, it has clearly deemed the answer to be "yes," thus giving the CEO a second chance. If it chooses a departure separation, it has clearly deemed the answer to be "no," and the CEO is on his or her way out the door. Below, we discuss how CEO career horizon predicts the answer to this second question.

If the answer to the second question is "yes," then the board will demote their CEO and appoint a new separate chair. We argue that for this to occur, the CEO must be sufficiently young with a long career horizon. This is because the presence of a performance problem indicates the need for a change of direction, which is inherently risky, both to the firm and to the CEO. Risk aversion is a commonly cited agency cost (Eisenhardt, 1989; Fama, 1980), and while an agency problem may have existed prior to separation, a younger CEO is less likely to be risk averse under the new arrangement than is an older CEO (Barker and Mueller, 2002; Matta and Beamish, 2008).

Risk also comes into play when discussing the CEO's potential career prospects outside the firm. Demotion separations are a pure governance play because they involve no change in CEO, only a change in the board's structure (Krause and Semadeni, 2013). They also, as the name suggests, strip the sitting CEO of a rank and title that he or she previously held. This highly public rebuke of the CEO's prior performance will likely create a stigma that will hurt the CEO's chances at future employment were he or she to leave the firm (Semadeni *et al.*, 2008). An older CEO would have less time to recover from such a setback (McClelland *et al.*, 2012). As executives

near retirement age, they begin worrying about their legacy and financial security after retirement (Brickley *et al.*, 1999; Matta and Beamish, 2008). Therefore, younger CEOs will be more willing to take the risk of being demoted and potentially turning the firm around, because they have the long career horizon. Because of this, it is by no means necessary to assume that demotions occur in defiance of a CEO's wishes, although that is probably the most likely scenario. As board chair, the CEO would certainly be privy to board deliberations, and could potentially even suggest a demotion separation in order to relieve him- or herself of the board chair's additional job demands (Hambrick *et al.*, 2005). In contrast, older CEOs would likely reject a demotion if offered to them, preferring instead to simply leave the firm and look for work without the stigma of demotion attached to them (Goffman, 1963; Semadeni *et al.*, 2008).

The research is fairly consistent on this subject: older executives are more risk averse and less likely to embrace change (Buchholtz and Ribbens, 1994; Stevens *et al.*, 1978; Wiersema and Bantel, 1992). If the answer to the first CEO–board chair separation question—Is there a performance problem?—is "yes," then change is required. Upper echelons theory suggests that CEOs with longer career horizons will be amenable to such change; CEOs with shorter career horizons will not. As a result, we now have a profile of each type of separation, and each involves a CEO of a different age. The oldest CEOs are nearing retirement and will maintain a desired status quo. Therefore, they are most likely to experience apprentice separations as previously hypothesized. The youngest CEOs are amenable to risk and change and will respond more positively to the imposition of a separate board chair. Therefore, they are most likely to experience demotion separations. Finally, should the board decide to separate the CEO and board chair roles, a CEO with a moderate career horizon, being too risk averse for demotion and too young to retire in an apprentice separation, will leave the firm, replaced by two different individuals.

Hypothesis 3a: Among firms undergoing a CEO–board chair separation, CEOs undergoing an apprentice separation have the shortest career horizons.

Hypothesis 3b: Among firms undergoing a CEO–board chair separation, CEOs undergoing a demotion separation have the longest career horizons.

Hypothesis 3c: Among firms undergoing a CEO–board chair separation, CEOs undergoing a departure separation have shorter career horizons than those undergoing a demotion separation and longer career horizons than those undergoing an apprentice separation.

Finally, while we expect CEO career horizon to directly impact the board's choice of separation type, we stress that the board calculations we are suggesting cannot occur in a performance vacuum. As a departure or a demotion separation implies that the answer to the first separation question—Is there a performance problem?—must be “yes,” the CEO's career horizon should primarily matter to the board when there is evidence of a problem and when the board can respond effectively to it. In essence, the theory we have developed provides for a configuration of factors that impacts the board's choice of CEO–board chair separation type. Before the board can take the CEO's career horizon into account and answer the second question—Can change be accomplished with the current CEO?—it must affirmatively answer the first question. Poor performance will trigger a “yes” answer to the first question, and an independent board, as discussed previously, is more likely to reach that conclusion and ask the second question, ultimately leading to a consideration of the CEO's career horizon. Therefore, we hypothesize an interaction effect between all three factors: poor performance, board independence, and CEO career horizon.

As we have stated, the decision to choose one of the correction separations (i.e., demotion or departure) rather than an apprentice separation comes down to firm performance. If there is no performance problem, then an apprentice separation is the most likely of the three. While we expect that apprentice separations will occur at lower career horizon levels across all conditions, we also expect that the effect of career horizon will strengthen as firm performance worsens. Without poor firm performance, there is nothing to trigger the choice between a demotion and a departure separation, and without that choice, CEO career horizon takes

on less significance. The fact that older CEOs are more risk averse only matters to the extent that a dramatic, personally risky change is required (Buchholtz *et al.*, 2003). Thus, CEO career horizon is most likely to have an effect on board decision making when firm performance is poor and the board seeks such a change.

Of course, as discussed above, the extent to which a board actually is focused on monitoring, and thus the extent to which it responds to firm performance in a manner consistent with prescriptive agency theory (Daily and Dalton, 1995), varies across firms and over time (Finkelstein and D'Aveni, 1994; Tuggle *et al.*, 2010). In Hypothesis 2, we predicted that the effect of firm performance on boards' choice of CEO–board chair separation type would be stronger for boards dominated by independent directors. Similarly, if firm performance dictates the extent to which CEO career horizon impacts separation type, then board independence will moderate that relationship as well. A board that is less independent, and thus less vigilant (Kroll *et al.*, 2008), will not only be less likely to respond to poor firm performance with a demotion or departure separation (i.e., Hypothesis 2), but also, given that they are less likely to have to choose between a departure and demotion separation—because they are less responsive to firm performance—they have less reason to consider CEO risk aversion in making their decision.

This reasoning paints a more concrete picture of each separation type's profile. Apprentice separations are the most likely option when firm performance is strong (Hypothesis 1), provided that board independence is high (Hypothesis 2). If board independence is low, performance has minimal impact on CEO–board chair separation type. To the extent that firm performance is poor and board independence is high, boards will consider CEO career horizon in deciding between a departure separation and a demotion separation, with longer-horizon CEOs remaining as CEO and shorter-horizon CEOs leaving the firm. Without poor performance and board independence, there is little reason to expect that boards will be concerned with the risk aversion of shorter-horizon CEOs.

Hypothesis 4: The effect of CEO career horizon on boards' choice of CEO–board chair separation type will be strongest when firm performance is poor and board independence is high.

METHODS

Our population for this study consists of all the firms in the Corporate Library database, which includes the firms in the S&P 1500 and Fortune 1000 indices, between 2003 and 2006. We chose these years because they constitute a period of substantial increase in the number of large firms separating their CEO and board chair roles (Spencer Stuart, 2011). In addition, we believe it to be good practice for studies in corporate governance to exclude years preceding the passage of the Sarbanes–Oxley Act of 2002. The law fundamentally changed so many aspects of corporate governance that examination of years prior to the law's passage limits a study's practical relevance. All governance data were retrieved from The Corporate Library's Companies, Directors, and CEOs databases. Performance and other financial data were retrieved from Compustat.

From this population, we drew a sample of all identifiable CEO–board chair separation events. We identified such an event as occurring when a firm reported a combined leadership structure in one year and a separate leadership structure in the following year. The final sample included 411 separations, consisting of 272 apprentice separations, 105 departure separations, and 34 demotion separations. Full data was available for 352 separations, consisting of 241 apprentice separations, 84 departure separations, and 27 demotion separations. Our control variables created most of the data constraints, so we ran our analyses without them, and the results improved in significance. Therefore, we believe that the models presented with controls, while including fewer separation events, represent more conservative analyses.

Dependent variable

Our dependent variable is categorical and consists of the three types of CEO–board chair separation described above. If the sitting CEO in the previous year remained CEO in the year of separation, the separation was labeled a *Demotion*. If the sitting CEO in the previous year was neither CEO nor board chair in the year of separation, the separation was labeled a *Departure*. If the sitting CEO in the previous year remained board chair in the year of separation, the separation was labeled an *Apprentice* separation. This categorization is consistent with Krause and Semadeni (2013).

Independent variables

We examined the effects of three independent variables in our study. We measured *Poor firm performance* by reverse-coding return on assets, calculated as annual net income divided by firm assets. We chose this measure because it is widely understood and commonly used in CEO succession research (e.g., Shen and Cannella, 2002). We measured *CEO career horizon* as the number of years remaining before the CEO reached the assumed retirement age of 70 (Matta and Beamish, 2008).² Finally, we measured *Board independence* as the percentage of board members who were neither inside directors nor affiliated directors.

Control variables

We included a number of control variables in our analysis. To control for industry-level differences in performance, career horizon, and board independence, we included *Industry ROA*, *Industry board independence*, and *Industry CEO career horizon* in our models, averaged at the four-digit SIC code. We calculated *CEO tenure*, the number of years the CEO has been in office, and *CEO ownership*, the percentage of company stock the CEO owns, in order to account for any effects of these other relevant CEO characteristics. We also controlled for *Firm size*, as measured by the number of employees at the firm.

Accounting for selection bias

As our sample consists only of CEO–board chair separation events, we must make sure that we rule out the possibility of sample selection bias prior to analyzing our data. If unmeasured factors are causing firms to separate their CEO and board chair roles, they could bias our results.³ To address this potential problem, we conducted a Heckman correction for selection bias by specifying a probit model of CEO–board chair separation as a dichotomous dependent variable. In this model, we predicted the occurrence of

² The number 70 is simply a reference point consistent with prior research. We included all available CEO ages, including those above 70, as the CEO's career horizon continues to decline with age even after reaching the typical retirement point. As a robustness check, we ran our analyses excluding CEOs older than 70, 65, and 60, and the results did not change.

³ We are indebted to an anonymous SMJ reviewer for identifying this issue.

CEO–board chair separation—regardless of separation type—with firm performance, percentage of stock held by institutions, and industry indicator variables serving as predictors. We then obtained the residuals from this model and included them as a control variable in our hypothesis-testing models described below. This variable, the inverse Mills ratio, is labeled *Heckman value*, consistent with Karaevli (2007).

ANALYSIS AND RESULTS

Descriptive statistics and pairwise correlations for our variables are shown in Table 1. Since our dependent variable consists of three mutually exclusive CEO–board chair separation types, we modeled boards' selection of each type with multinomial logistic regression, a common method for predicting discrete choice from among three or more alternatives (Zhang and Rajagopalan, 2003, 2004). Multinomial logit analysis allows us to model the selection of all three separation types simultaneously. While any of the three types could have served as the base case in our models, we chose to use apprentice separations as the base case because they are the most common. All independent variables are lagged one year. The results of these analyses are shown in Tables 2 and 3.

In Table 2, we test Hypotheses 1 through 3. Our multinomial logit analysis models the likelihood that boards will select either a departure separation or a demotion separation, as opposed to an apprentice separation, which is the base case scenario. Model 1 includes only the effects of industry-level control variables on boards' choice of separation type, and Model 2 includes all control variables. Model 3 introduces the tests of our main effect hypotheses. In this model, we can see that Hypothesis 1a, which states that poor performance will increase the likelihood of a departure separation, is not supported. The coefficient is in the correct direction, but is not significant. In contrast, Hypothesis 1b, which states that poor performance will increase the likelihood of a demotion separation, did receive support ($\beta = 0.496$, $p < 0.05$).

In Models 4 and 5, we test Hypotheses 2a and 2b, which state that the effect of poor performance on departure and demotion separation selection, respectively, will be greater when board independence is high than when it is low. We test

Table 1. Correlations and descriptive statistics

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11
1 Apprentice separation	0.683	0.466											
2 Departure separation	0.241	0.428	-0.819										
3 Demotion separation	0.076	0.266	-0.420	-0.176									
4 Poor performance	-0.008	0.233	-0.119	0.021	0.167								
5 Board independence	0.685	0.150	-0.096	0.085	0.031	0.061							
6 CEO career horizon	10.949	7.894	-0.294	0.157	0.256	0.175	0.020						
7 Industry ROA	0.027	0.059	0.071	-0.064	-0.021	-0.411	0.005	-0.081					
8 Industry board independence	0.686	0.052	0.037	-0.034	-0.009	0.048	0.356	-0.114	-0.045				
9 Industry CEO career horizon	15.412	2.159	-0.090	0.026	0.112	0.056	-0.031	0.340	-0.087	-0.165			
10 CEO tenure	9.521	8.445	0.150	-0.087	-0.120	-0.088	-0.210	-0.396	0.025	-0.005	-0.149		
11 CEO ownership	0.006	0.070	0.046	-0.035	-0.023	-0.017	-0.086	-0.064	0.072	-0.087	-0.030	0.161	
12 Firm size	19.902	53.245	-0.009	0.030	-0.032	-0.042	0.031	-0.084	0.046	-0.065	-0.020	0.084	-0.002

$N = 352$ All correlations with magnitude greater than 0.12 are significant at the $p < 0.01$ level.

Table 2. Multinomial logit models

	Departure separations						Demotion separations					
	Model 1			Model 2			Model 3			Model 4		
	Industry controls	All controls	Full sample	High B.I.	Low B.I.	Model 5	Industry controls	All controls	Full sample	High B.I.	Low B.I.	Model 5
Constant	-1.165*** (0.178)	-1.103*** (0.198)	-0.874*** (0.215)	-0.413 (0.371)	-1.304*** (0.328)	-2.184*** (0.280)	-2.185*** (0.250)	-1.826*** (0.384)	-1.799*** (0.602)	-1.826*** (0.602)	-1.799*** (1.427)	-3.224* (1.427)
Heckman value	-0.385 (0.374)	-0.284 (0.379)	-0.092 (0.437)	-0.294 (0.708)	0.018 (0.653)	0.024 (0.627)	0.132 (0.633)	1.699† (0.885)	-0.054 (1.202)	-0.054 (1.202)	-0.054 (1.760)	3.767* (1.760)
Industry ROA	-0.075 (0.128)	-0.091 (0.130)	-0.001 (0.154)	0.587† (0.345)	-0.354 (0.250)	-0.152 (0.184)	-0.150 (0.187)	0.188 (0.270)	0.310 (0.574)	0.310 (0.574)	-0.421 (0.384)	-0.421 (0.384)
Industry board independence	-0.131 (0.341)	-0.410 (0.376)	-0.335 (0.381)	-0.579 (0.614)	-0.581 (0.535)	-0.104 (0.577)	-0.238 (0.607)	-0.153 (0.640)	-0.084 (1.146)	-0.084 (1.146)	-0.075 (0.882)	-0.075 (0.882)
Industry CEO career horizon	0.309 (0.362)	0.181 (0.367)	-0.183 (0.388)	-1.553* (0.641)	0.752 (0.635)	1.117† (0.667)	0.936 (0.667)	0.323 (0.733)	-0.673 (1.194)	-0.673 (1.194)	0.997 (1.135)	0.997 (1.135)
CEO tenure	-6.2222† (3.684)	-3.194 (3.991)	-13.101† (7.451)	1.111 (5.173)	-10.447 (7.076)	-10.447 (7.076)	2.313 (7.994)	2.685 (13.295)	5.650 (11.170)	5.650 (11.170)		
CEO ownership	-0.388 (0.599)	-0.510 (0.617)	-0.157 (1.231)	-0.655 (0.812)	-1.465 (1.563)	-1.465 (1.748)	-2.227 (1.748)	1.387 (1.857)	-13.767 (8.523)	-13.767 (8.523)		
Firm size	0.084 (0.146)	0.121 (0.148)	-0.206 (0.293)	0.521 (0.332)	-0.086 (0.333)	-0.086 (0.333)	0.121 (0.313)	0.051 (0.313)	0.098 (0.630)	0.098 (0.630)		
Board independence	0.261 (0.163)	0.287† (0.169)	0.261 (0.169)	0.521 (0.169)	0.036 (0.245)	0.036 (0.245)	0.111 (0.261)	0.111 (0.261)				
Poor performance	0.157 (0.172)	0.839* (0.343)	-0.102 (0.196)	0.496* (0.217)					0.256 (0.350)			
CEO career horizon	0.469*** (0.152)	0.570* (0.241)	0.371† (0.216)	1.515*** (0.264)	1.515*** (0.413)	1.515*** (0.452)	1.515*** (0.413)	1.515*** (0.452)	1.071* (0.452)	1.071* (0.452)		
Observations	352	352	352	352	352	352	352	352	178	178	174	
Log likelihood	-277.583	-270.668	-252.859	-126.616	-105.821	-277.583	-270.668	-252.859	-126.616	-126.616	-105.821	
Chi-squared	6.806	20.636	56.255	52.251	39.471	6.806	20.636	56.255	52.251	52.251	39.471	
Pseudo R-squared	0.012	0.037	0.100	0.171	0.157	0.012	0.037	0.100	0.171	0.171	0.157	

All independent variables are standardized. Significance scores are results of two-tailed z -tests. Standard errors in parentheses. B.I. = board independence.

in independent variables at standard size. Significant differences are indicated by asterisks: $p < 0.10$; $*$ $p < 0.05$; $**$ $p < 0.01$; $***$ $p < 0.001$.

Table 3. Multinomial logit test of three-way interaction

	Departure separations						Demotion separations			
	Model 6		Model 7		Model 8		Model 9		Model 6	
	High B.I. Poor performance.	High B.I. Strong performance	Low B.I. Poor performance	Low B.I. Strong performance	Low B.I. Strong performance	High B.I. Poor performance	High B.I. Strong performance	Low B.I. Poor performance	Low B.I. Strong performance	Model 9
Constant	0.671 (0.518)	-2.387* (1.080)	-1.321** (0.467)	-1.474** (0.556)	-5.368 (4.367)	-2.205 (1.772)	-3.216 (2.209)	-7.446† (4.180)		
Heckman value	-0.131 (0.943)	-0.987 (1.234)	-0.099 (0.782)	1.119 (1.118)	-0.540 (1.245)	0.029 (4.532)	2.563 (2.105)	0.215 (5.209)		
Industry ROA	0.445 (0.454)	1.029† (0.541)	-0.333 (0.262)	0.374 (0.435)	0.215 (0.541)	-1.630 (1.916)	-0.247 (0.551)	-0.851 (1.106)		
Industry board independence	-1.001 (1.021)	-0.506 (0.876)	-2.087* (0.998)	0.373 (0.859)	0.483 (1.354)	1.729 (2.660)	1.906 (1.692)	-1.975 (1.840)		
Industry CEO career horizon	-2.300* (1.020)	-0.718 (1.011)	1.177 (0.925)	1.090 (1.261)	-0.190 (1.793)	-2.039 (4.168)	0.909 (1.903)	3.922 (3.472)		
CEO tenure	-3.384 (9.032)	-30.585† (15.717)	4.628 (6.959)	-1.800 (9.936)	12.830 (19.647)	-32.883 (32.789)	10.341 (13.719)	19.897 (27.576)		
CEO ownership	0.667 (1.326)	-3.278 (5.353)	0.469 (1.260)	-1.446 (1.765)	-28.311 (25.339)	9.288* (4.608)	-16.498 (13.083)	-9.300 (11.006)		
Firm size	-0.040 (0.265)	-1.124 (0.828)	0.291 (0.676)	0.576 (0.420)	0.324 (0.679)	1.086 (1.284)	0.673 (0.872)	-8.456 (11.655)		
CEO career horizon	1.594*** (0.427)	-0.504 (0.413)	0.256 (0.311)	0.567 (0.359)	2.890*** (0.704)	1.196 (0.948)	1.130† (0.614)	1.244 (0.917)		
Observations	98	80	78	96	98	80	78	96		
Log likelihood	-68.327	-43.465	-55.710	-37.732	-68.327	-43.465	-55.710	-37.732		
Chi-squared	49.745	24.702	27.449	26.487	49.745	24.702	27.449	26.487		
Pseudo R-squared	0.267	0.221	0.198	0.260	0.267	0.221	0.198	0.260		

All independent variables are standardized. Significance scores are results of two-tailed z -tests. Standard errors in parentheses. B.I. = board independence.

† $p < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

this interaction effect by splitting our sample at the median value of board independence and modeling the effect of poor performance on separation type selection at above and below median levels of board independence. We chose this method of testing an interaction because, as Ai and Norton (2003) have shown, a multiplicative interaction term in a nonlinear model does not always produce the correct sign or magnitude. To address this problem, we adapted a solution suggested by Shaver (2007)—and implemented by Penner-Hahn and Shaver (2005)—and split our sample at the median value for board independence.

Model 4 represents the analysis at above-median board independence, and Model 5 represents the analysis at below-median board independence. The relevant coefficients and standard errors are shaded in gray. As Table 2 shows, the coefficient for poor performance is significant for both departure ($\beta = 0.839, p < 0.05$) and demotion separations ($\beta = 1.288, p < 0.01$) in Model 4 and is not significant for either category in Model 5. We conducted seemingly unrelated estimation (Clogg *et al.*, 1995), which confirmed a significant difference between the two models for both departure ($\chi^2 = 5.52, p < 0.05$) and demotion separations ($\chi^2 = 3.85, p < 0.05$). These results provide strong support for Hypotheses 2a and 2b.

Next, we tested Hypothesis 3 in Model 3. Hypothesis 3a states that the sitting CEO's career horizon will be shortest for apprentice separations. For this hypothesis to receive empirical support, the career horizons of CEOs undergoing apprentice separations must be significantly shorter than the career horizons of those undergoing either departure or demotion separations. As Table 2 shows, the coefficient for CEO career horizon is positive and significant for departure separations ($\beta = 0.469, p < 0.01$) as well as for demotion separations ($\beta = 1.086, p < 0.001$), supporting Hypothesis 3a. Hypothesis 3b states that CEO career horizon will be longest for CEOs undergoing demotion separations, and Hypothesis 3c states that CEOs undergoing departure separations will have longer horizons than those undergoing apprentice separations and shorter horizons than those undergoing demotion separations. For these hypotheses to receive empirical support, Hypothesis 3a must be supported and the CEO career horizon coefficient for demotion separations must be significantly greater than the CEO career horizon coefficient for departure separations. We test this

hypothesis using a Wald χ^2 test of the difference between the two CEO career horizon coefficients. The Wald χ^2 test revealed that CEO career horizon was significantly longer for CEOs undergoing demotion separations than for CEOs undergoing departure separations ($\chi^2 = 5.21, p < 0.05$), supporting Hypothesis 3b. Since Hypothesis 3a also received support, we can conclude that Hypotheses 3a, 3b, and 3c were all supported.

Finally we test the three-way interaction proposed in Hypothesis 4 using the median split method described previously (Shaver, 2007). The results of these tests are shown in Table 3. Hypothesis 4 states that the effects of CEO career horizon will be strongest when firm performance is poor and board independence is high. We test this hypothesis by splitting our sample into four mutually exclusive subsamples: above-median poor performance and above-median board independence (Model 6), below-median poor performance and above-median board independence (Model 7), above-median poor performance and below-median board independence (Model 8), and below-median poor performance and below-median board independence (Model 9). We then examine the strength of the CEO career horizon coefficient under each of the four listed conditions.

As Table 3 shows, when performance is poor and board independence is high, the effect of CEO career horizon on the likelihoods of both departure separations ($\beta = 1.594, p < 0.001$) and demotion separations ($\beta = 2.890, p < 0.001$) strengthens both in magnitude and significance. In fact, the effect of CEO career horizon on departure and demotion separations virtually disappears under any other circumstances. Seemingly unrelated estimation confirmed the significant difference between the four models for both departure ($\chi^2 = 5.88, p < 0.05$) and demotion separations ($\chi^2 = 3.78, p < 0.10$). From these results, we can conclude that the CEO career horizon difference between apprentice separations and the other two is strongest when board independence is high and performance is poor. As with Hypothesis 3, fully testing Hypothesis 4 requires evaluating whether the CEO career horizon difference between demotion and departure separations is also strongest under these conditions. Once again, the difference between the CEO career horizon coefficients for departure and demotion separations is significant when firm performance is poor and board independence is high ($\chi^2 = 4.74, p < 0.05$), but

is not significant under any of the other three conditions. As such, we find strong support for Hypothesis 4.

We conducted a few robustness checks to assess the validity of our results. In order to validate our method of testing interaction effects, we conducted the same analyses, but split the samples at the mean values of board independence and poor performance instead of the median, and we also examined the full sample using the traditional moderated regression technique of testing a product-term interaction. In both cases, the results did not materially change. In addition, we added year dummy variables to our analyses to control for possible year-specific effects (Certo and Semadeni, 2006). Again, the results remained unchanged. As such, we feel very confident in the validity of our findings.

DISCUSSION

Agency theory predicts that boards fulfilling their monitoring responsibilities will respond to poor performance by separating their CEO and board chair roles if they are currently combined. Nevertheless, prior research in this area has failed to produce conclusive evidence in support of this theory (Daily and Dalton, 1995; Linck *et al.*, 2008). We argue that this lack of confirmatory evidence stems from misspecification of the CEO–board chair separation construct. Using Krause and Semadeni's (2013) classification of CEO–board chair separation types, we postulated that each type has its own profile, and thus requires separate specification. Drawing on agency theory, we found that departure and demotion separations—the correction separations—do follow poor firm performance, whereas apprentice separations do not. This effect held, however, only when board independence was high. Consistent with agency theory, we found that low board independence reduced the board's vigilance in monitoring the firm's performance (Finkelstein and D'Aveni, 1994).

In addition to performance and board independence, CEO career horizon exhibited a substantial effect on boards' choice of separation type. Drawing on upper echelons theory, we hypothesized that each type of separation would be most likely to occur at different points on the CEO career horizon, with demotion separations occurring to CEOs with the longest horizons, apprentice separations

occurring to CEOs with the shortest horizons, and departure separations occurring to CEOs in the middle. Our results strongly supported this intuition. In our sample, the mean ages of CEOs undergoing demotion, departure, and apprentice separations were 52.1, 56.8, and 60.7 years, respectively. The nearly even spacing of these groups' mean ages only underscores the extent to which separation type is a discrete choice for boards, as well as the extent to which CEO career horizon weighs on that choice.

This paper contributes to the developing theory on CEO–board chair separation. In a recent examination of the consequences of CEO–board chair separation, Krause and Semadeni (2013) found that only demotion separations impacted future firm performance with any practical significance, and that this impact was only positive if past performance was poor. They reasoned that this was because demotion separations were a pure governance play and only proper in response to a performance problem (Krause and Semadeni, 2013). Such reasoning highlights the practical significance of our results, which suggest that boards do choose demotion separations in times of poor performance (if the board is independent). However, they also choose departure separations under such conditions. The difference we find in terms of CEO career horizon illuminates the difference between the two. If the CEO is young enough, the board will likely take the chance of keeping him or her around with the hope that an independent board chair will work with the incumbent CEO to produce better firm outcomes. If the CEO is not young enough, the board will cut its losses and opt for two new individuals to replace the outgoing CEO/board chair.

Our paper also extends the theoretical profile of the apprentice separation. Quigley and Hambrick (2012) developed and tested several hypotheses around the effects of keeping the former CEO as board chair. They showed that, consistent with our theory, retaining the outgoing CEO as board chair impedes strategic change. As a corollary, lower strategic change impedes performance growth. While Quigley and Hambrick (2012: 835) did not test the antecedents of the phenomenon they studied, they did speculate that "predecessor retention will tend to occur if the board welcomes the former CEO's continued influence." We directly test this assertion by showing that apprentice separations occur at higher-performing

firms than do departure or demotion separations. In addition, we corroborate Quigley and Hambrick's intuition that such events are primarily the planned retirement of the outgoing CEO.

Finally, we contribute further evidence that the construct of CEO career horizon is one with meaningful theoretical implications, and not just a convenient control variable. Recent work has begun to explore the ways in which CEO age impacts firm-level actions and outcomes (Barker and Mueller, 2002; Matta and Beamish, 2008), but governance scholarship has only begun to scratch the surface of an effect that Hambrick and Mason (1984) predicted nearly three decades ago. Our paper extends the conversation on the risk aversion of older CEOs, and we hope that future research will pick up the conversation where we left off.

CONCLUSION

In this paper, we examined the antecedents of CEO–board chair separation. Our results show that the three types of separation each have different profiles in terms of the prior performance of the firm, the independence of the board, and the career horizon of the incumbent CEO. We theorize that firms choosing a type of separation must first determine (1) whether a performance problem exists; and then (2) whether the incumbent CEO should remain in that position. An answer of “no” to the first question yields an apprentice separation. An answer of “no” to the second question yields a departure separation, whereas an answer of “yes” yields a demotion separation. The findings in this paper provide unique insights into the factors that drive boards' structural choices. As questions about board leadership structure become more nuanced and more relevant in both scholarship and practice, a full understanding of these factors will only become more important.

ACKNOWLEDGEMENTS

We wish to thank Dan Dalton, Kim Whitler, coeditor Richard Bettis, and two anonymous SMJ reviewers for their helpful comments on earlier drafts of this paper.

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