

## WHAT'S ALL THAT (STRATEGIC) NOISE? ANTICIPATORY IMPRESSION MANAGEMENT IN CEO SUCCESSION

SCOTT D. GRAFFIN,<sup>1\*</sup> MASON A. CARPENTER,<sup>2</sup> and STEVEN BOIVIE<sup>3</sup>

<sup>1</sup> *Terry College of Business, University of Georgia, Athens, Georgia, U.S.A.*

<sup>2</sup> *University of Wisconsin, Madison, Wisconsin, U.S.A.*

<sup>3</sup> *Eller College of Management, Department of Management and Organizations, University of Arizona, Tucson, Arizona, U.S.A.*

*We develop and test a novel theory about strategic noise with regard to CEO appointments. Strategic noise is an anticipatory and preemptive form of impression management. At the time it announces a new CEO, a board of directors seeks to manage stakeholder impressions by simultaneously releasing confounding information about other significant events. Several CEO and firm characteristics affect the likelihood that this will happen. Strategic noise is most likely when long-term CEOs have a wide pay gap between other top managers at high stock price performance firms, and when a new CEO does not have previous CEO experience or comes from a less well-regarded firm. Results showing that CEO succession announcements are noisier than they would be by chance have some interesting implications for impression management theory, traditional event study methodology, and managerial and public policy. Interviews with public firm directors on CEO succession provide additional validity for the strategic noise construct and help us to articulate key elements of the theory. Copyright © 2011 John Wiley & Sons, Ltd.*

## INTRODUCTION

There is a growing literature on impression management; that is, organizations seek to influence stakeholder reactions to events intentionally. Organizational impression management describes any action carried out with the intent of influencing an audience's perception of the organization (Elsbach, Sutton, and Principe, 1998).

Early impression management research shows that firms will attribute unfavorable outcomes to their external environment but will take credit for favorable outcomes (Bettman and Weitz, 1983), and that the corresponding self-serving descriptions of firm performance can result in higher

stock prices (Staw, McKechnie, and Puffer, 1983). Impression management can relate to executive compensation (Zajac and Westphal, 1995; Wade, Porac, and Pollock, 1997; Porac, Wade, and Pollock, 1999) and to strategic change (Gioia and Chittipeddi, 1991; Fiss and Zajac, 2006). Puffer and Weintrop (1991) and Zajac and Westphal (1995) conclude that organization leaders actively manage their firm's informational environment, and do so in ways they hope will favorably affect the impressions of targeted stakeholders. Three basic premises in organizational impression management research are (1) markets are not perfectly efficient, (2) reactions of observers and markets may be influenced by the actions and tactics of firms and, therefore, (3) organization leaders try to influence stakeholder reactions by mitigating the information asymmetry as to their motives behind why, when, and how they chose to act (Porac *et al.*, 1999).

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\*Correspondence to: Scott D. Graffin, Terry College of Business, University of Georgia, 404 Brooks Hall, Athens, GA 30602, U.S.A. E-mail: sgraffin@terry.uga.edu

Impression management may be particularly important in the context of chief executive officer (CEO) succession; even if a board believes it has chosen a good successor, there is no guarantee that the market will respond positively to the announcement of the appointment. Moreover, as reaction to the CEO announcement will be largely determined by reports in the press, directors may not have confidence that the new CEO will be accurately described (Waine, 2002). It is, thus, not surprising that a firm's leaders might seek to manage external impressions at this important time in an organization's life. Our premise is that because boards cannot predict the market's reaction with certainty, and because they control the timing and details of the CEO announcement, they will have the incentive and ability to manage the announcement process.

Accordingly, we develop a theory of strategic noise and test it in the context of CEO succession. Our theory takes impression management in a different direction from most research to suggest how publication of multiple pieces of significant information simultaneously makes it difficult, if not impossible, to interpret the effect of any one piece of information in isolation. Strategic noise occurs when: (1) two or more important events are announced simultaneously; (2) the timing of announcements is under the control of the organization; and (3) announcements are neither intended to clarify nor are they causally related to the initial event. That is, strategic noise is characterized by impression management activities that are anticipatory, preemptive, and obfuscatory. It allows an organization's leaders to rationalize market reactions because noise provides an alternative explanation for any negative change in the firm's stock price. Strategic noise in this case may give a new CEO some breathing room.

We test two related propositions. First, CEO successions are noisier than would be expected by chance. Given that organizations control the events surrounding a CEO succession, a disproportionate number of noisy CEO successions would suggest that organizations are releasing information to coincide with the succession. Second, key characteristics of the CEO and the firm will affect the likelihood that a firm will introduce strategic noise at the same time as a succession announcement. Exploration of this second proposition helps us analyze how the causes of strategic noise vary across firms. As strategic noise-related impression

management has received little attention, we add to our deductive study data from interviews of directors. This qualitative information helps to illuminate our theory of strategic noise.

## STRATEGIC NOISE

Prevailing views of impression management suggest organizational leaders will seek to release information to influence stakeholders in one way or another. When directors are uncertain as to how stakeholders may react, and when certain reactions can be damaging, they may have considerable motivation to manage stakeholder impressions by using strategic noise.

Elsbach *et al.* (1998) develop the construct of *anticipatory obfuscation*; they note that it is a distinct form of impression management for two reasons. First, unlike most other forms, it does not occur in response to stakeholder reactions. Higgins and Snyder observe that 'organizations ... have the ability and the need to anticipate possible futures' (1989: 77) and will take preemptive action to protect themselves against possible negative reactions to uncertain events. Second, anticipatory obfuscation is most likely to be used 'when it is unclear that an organizational event will be negative' (Elsbach *et al.*, 1998: 82–83). In ambiguous circumstances, firms may engage in anticipatory obfuscation to minimize direct scrutiny of the event.

We propose that firm leaders may inject strategic noise by timing other important press releases to coincide with the announcement of the new CEO; or, a board can time the announcement of a new CEO to coincide with other important corporate communications. Whatever tactic is used, in both instances the effect of announcing the new CEO on the firm's stock price is 'confounded' by the effects of the other announcements.

A *confounding event* is a significant happening that may independently influence an organization's stock price; examples include changes in dividend policy, earnings guidance and earnings announcements, announcements of mergers and acquisitions, and any other significant event (McWilliams and Siegel, 1997). Confounding events are an element of screening in an event study; that is, if a firm experiences a confounding event at roughly the same time as the event of interest, that firm is excluded from the analysis because shareholder

reaction to the event of interest is impossible to ascertain in isolation from the confounding event(s).

Confounding events are typically treated as random noise that prevents the analysis of shareholder reaction to an event. We theorize, however, that such noise can be systematic (and strategic), because firm leaders use it purposefully to minimize the effect of a potentially negative reaction to an event of interest.

### Strategic noise in already noisy markets

We assume a CEO succession occurs when a firm announces the appointment of a new CEO.<sup>1</sup> The CEO is the ultimate decision maker in an organization; thus, CEO succession is a key organizational change (Kesner and Sebora, 1994). At this time, there is both internal and external uncertainty regarding how well the new CEO may perform and how the stock market may respond to the appointment announcement (Kesner and Sebora, 1994; Khurana, 2002; Lorsch and Khurana, 1999). A positive stock market response is not certain, and a negative stock market response may severely hamper the early tenure of the new CEO (Khurana, 2002). One director interviewed for our study summarizes the issue this way:

*We've tried to avoid any second guessing [by the stock market] by making sure that we announce the new CEO at a time when a lot of other stuff is going on. This way, if the market does react negatively, it's pretty easy to say it was not the CEO announcement. . . . our goal is [to] get the CEO into place where they can prove their mettle, but avoid being saddled out of the box with a negative impression.*

A swift negative stock market reaction would suggest that stockholders may not consider the new

<sup>1</sup> Announcements that a CEO is stepping down and a new CEO is named are sometimes decoupled (8% of our sample). In the decoupled cases, we focus on the naming of the new CEO for two reasons. First, Shen and Cannella (2003) find that shareholders react positively to the promotion of a previously named 'heir apparent' to CEO, suggesting that shareholders are uncertain as to who the next CEO will be until that is explicitly announced by the firm. Second, our review of the releases that announce only that a CEO is stepping down indicate that such releases are often open ended, and it is not clear when and if this is actually going to happen. Our results and conclusions are largely unchanged when we reanalyze our data using the announcement that the outgoing CEO is stepping down.

CEO legitimate, and that the firm's board is also failing to manage the CEO succession process properly. In the words of another director:

*If the stock tanks after our announcement then I think . . . what did we miss? Can't help to have buyer's remorse and that really dampens the energy buoying an incoming CEO.*

It is in just such ambiguous situations that organizational leaders are most likely to act to minimize the potential downside of a negative reaction by stakeholders (Elsbach *et al.*, 1998; Pfeffer, 1981).

CEO succession may present an opportunity for firms to exploit strategic noise for at least two reasons. First, CEO choices typically are made behind closed doors, and information about the way a board selects a CEO is rarely shared (Lorsch and Khurana, 1999; Shen and Cannella, 2003). This allows firm leadership to decide if, when, and what information is shared. Because this process unfolds privately, shareholders, as well as members of the financial press reporting the event, do not have access to information until organization leaders decide to release it. When combined with the importance of CEO succession, this control creates a sort of information pressure cooker, where the board has the opportunity, incentive, and ability to manage the information context. Specifically, boards possess unique information about how the CEO was selected and also have unique control over when that information is released.

Second, despite numerous studies showing that shareholders *do* react to CEO succession, there is little theoretical or empirical consensus as to how they will react—positively, neutrally, or negatively. Predicting how shareholders will react is difficult because evaluating the quality of management by stakeholders external to the organization is an uncertain process (Khurana, 2002). Authors struggling to establish some links have examined CEO characteristics including CEO management style (Guest, 1962); the fit between CEO characteristics and industry conditions (Datta and Rajagopalan, 1998); CEO personality (Peterson *et al.*, 2003); and CEO charisma (Flynn and Staw, 2004). Research on CEO succession provides no straightforward recommendations for directors searching for CEOs (Finkelstein, Hambrick, and Cannella, 2009: 164–226). Khurana notes that

because '...it is difficult, if not impossible, to know *ex ante* what characteristics in a CEO are needed to improve performance, directors are left to guess about which criteria are likely to be associated with success' (2002: 102).

Studies assessing how shareholders react to CEO successions have met with mixed results (Finkelstein *et al.*, 2009). Davidson, Worrell, and Cheng (1990) find that shareholders of *Fortune* 500 companies responded positively to the announcement of a CEO succession. Furtado and Karan (1990) find no abnormal returns based upon insider or outsider origin, and others find that shareholders respond positively to outsider selection (Chung *et al.*, 1987; Harris, Lauterbach, and Vu, 1994). Still others have found that the market responds positively when an outsider is promoted to CEO (Worrell, Davidson, and Glascock, 1993). Warner, Watts, and Wruck (1988), however, report that shareholders react negatively to outside successions, and others have found positive shareholder reactions to inside promotions (Furtado and Rozoff, 1987; Worrell and Davidson, 1987) as well as 'relay successions,' where a sitting CEO appoints and promotes a colleague (Shen and Cannella, 2003).

Scholars have noted that investor reaction to CEO successions may be influenced by characteristics of the firm, characteristics of the outgoing and incoming CEO, and several other factors (Kesner and Sebora, 1994; Finkelstein, *et al.*, 2009). In sum, prior studies highlight the fact that it is virtually impossible for boards to be able to predict stock market reactions to CEO announcements with certainty. The interdependence of the myriad factors makes board members unsure of shareholder reaction, thus they might want to hedge against negative market responses by strategically creating noise around CEO succession announcements. Furthermore, even if directors were certain they had hired the correct person to lead the firm, they could not be certain how shareholders would react to the hiring. At the same time, directors might fear a preemptory repudiation of a newly appointed CEO for reasons of incomplete or inaccurate information.

Elsbach *et al.* (1998) label such events as *ambiguously negative* because it is difficult to predict stakeholder reaction. Such a description fits the context of CEO succession well. The ambiguity is considered negative because stakeholder reactions are unpredictable and can have significant negative

future repercussions for the CEO. According to Elsbach and colleagues, it is in such situations that 'the organization will attempt to maintain ambiguity by minimizing audiences' scrutiny of the event so that audience members do not assign negativity to the event' (1998: 83). Consistent with this contention, one of the directors we interviewed commented:

*I just want to be sure that the CEO comes into the role on their own terms, and is not unduly constrained by what the market has 'said' about their potential. The market may be efficient over time, but a bad response [on the announcement date] really weighs heavily on the spirit of the board and their relationship with the new CEO.*

A negative market reaction may threaten a new CEO's tenure before it begins (Khurana, 2002). Such repudiation may contribute to the high rate of dismissals for CEOs early in their tenure (Ocasio, 1994), a rate that has recently reached record levels (Kaplan and Minton, 2006). Indeed, in 2007, 81 CEOs at the world's top 500 companies left their jobs (Zendrian, 2008). Thus the injection of strategic noise may give CEOs more time to succeed or fail on their own merits.

A strong negative market reaction to a newly hired CEO also is likely to reflect poorly on the board of directors because managing the CEO succession process is considered one of a board's most important duties (Vancil, 1987; Lorsch and MacIver, 1989). In fact, the credit or blame directors receive in this setting is asymmetric. On the one hand, if the new CEO performs well, he or she will reap the majority of the credit (Meindl, Ehrlich, and Dukerich, 1985). On the other hand, if the CEO stumbles, the board may be considered 'asleep at the wheel' (*Business Week*, 2005) and condemned in the financial press or even subjected to lawsuits.

Such negative outcomes can be costly for directors in terms of money and reputation (Sahlman, 1990). Gilson (1990), Srinivasan (2005), and Arthaud-Day *et al.* (2006) suggest that directors associated with negative events such as bankruptcy, poor performance, or fraud are more likely to lose their board appointments. Others suggest that individuals associated with negative outcomes may suffer negative stigma or 'taint' (Kang, 2008; Semadeni *et al.*, 2008).

	Positive	Negative
No strategic noise	<p>Uequivocally positive <i>Corporate representative can plausibly claim that the reaction is the market's confirmation of the new CEO announcement.</i></p>	<p>Uequivocally negative <i>Corporate representatives have the desire to manage impressions but any spin would not be credible.</i></p>
Strategic noise present	<p>Vaguely (or equivocally) positive <i>Corporate representative can plausibly claim that the reaction is the market's endorsement of the new CEO announcement. This is plausible if the additional news released is positive or negative.</i></p>	<p>Equivocally negative <i>Corporate representative can plausibly claim that the market reaction is not directly linked to the announcement of the new CEO.</i></p>

Figure 1. Reaction of the stock market to the new CEO announcement

### CEO succession and strategic noise

If they inject strategic noise into the CEO succession, firm leaders are attempting to obscure the most important tool of evaluation available to external stakeholders—the subsequent change in the firm's stock. For example, after John Walter was named CEO of AT&T its market valuation dropped by \$4 billion. This move in stock price was then used as evidence that the board had made a mistake in promoting Walter (Khurana, 2002). While any strategic noise in the CEO succession may not directly change the opinion of stakeholders, it could prevent them from using the stock market reaction as an objective piece of evidence because the presence of other important firm announcements may also have affected the market reaction. We do not assert that strategic noise will deceive the market, but we do suggest that it may allow a firm to advance alternative explanations for potentially strong negative market reactions. When strategic noise is present it becomes easier to tell the press or others that a drop in stock price is related to factors other than announcement of the new CEO.<sup>2</sup> We are not claiming that strategic noise will actually reduce the size or valence of the market's reaction to the announcement of a CEO succession (although it may). In fact, as we argue

in the discussion section, future research should explore this proposition. Instead we are arguing that uncertainty regarding the CEO succession process may give firms and directors an incentive to inject strategic noise. This incentive may be based upon the hope that strategic noise will influence the market reaction itself, but it may also be based on the belief that it allows the firm the opportunity to manage or contest said reaction.

Figure 1 describes four possible outcomes of the announcement of a new CEO appointment. When the stock market reaction is negative and strategic noise is present (lower right), representatives of a corporation can more plausibly present alternative explanations or rationalizations of the market reaction that are not directly linked to the market's perception of the new CEO. If strategic noise is present and the market reaction is positive (lower left), firm representatives can very easily claim that the positive market reaction is due to the CEO. The presence of strategic noise may not change the reaction of the market, but it does give the firm a chance to manage public impressions of the market reaction.

We acknowledge that any impression management is likely to have benefits that are temporary at best, because the market will eventually respond to actual actions a CEO takes. Strategic noise however, may give a new CEO breathing room in which to make useful actions. This idea is consistent with some of the information garnered from director interviews:

*We made sure we had other corporate announcements, both positive and negative. Really, the*

<sup>2</sup> Our theory, consistent with the impression management literature more generally, assumes that strategic noise will be introduced in order to reduce or manage possible negative outcomes associated with negative stock market reactions to a new CEO appointment. Strategic noise that is positive in nature may also be designed to 'prime the pump,' and reduce the extent of a negative market reaction. Reducing the extent of the negative market reaction would have similar net effects.

*more information we can put out at once, the better the CEO has a chance to make a strong start out of the gate by earning their reputation based on performance, not the market's second guess on what their performance will be.*

Thus, our theory suggests that organizations are particularly likely to introduce strategic noise at the time of CEO succession announcements, and we hypothesize:

*Hypothesis 1: CEO successions will be noisier than predicted by chance.*

## CONTEXT AND STRATEGIC NOISE

Support for Hypothesis 1 does not rule out an alternative explanation: a higher-than-expected confound rate may be an artifact of the administrative process in implementing major corporate decisions. That is, for example, an organization's leaders may decide many significant matters at board meetings and then release information on the decisions made simultaneously. A higher-than-chance rate of strategic noise would thus not definitively indicate strategic intent.

To better determine if strategic noise represents the intention to engage in anticipatory obfuscation, we develop hypotheses regarding the context surrounding the announcement. We suggest that firm leaders may have little motivation to resort to strategic noise in some CEO successions, while in other instances they may be highly motivated to do so.

We rely on prior research to identify observable characteristics of the outgoing CEO, the firm, and the incoming CEO that could heighten or suppress the likelihood that directors might inject strategic noise at the time of the succession announcement. The systematic influence of such contingencies would provide *prima facie* evidence that the injection of strategic noise is not merely an artifact of the administrative process.

### Outgoing CEO characteristics

Even responsible and competent directors may be uncertain as to how shareholders will react to their choice of CEO. While many factors may influence how risky directors may perceive a given

CEO choice to be, we focus on two of the more salient characteristics of an outgoing CEO: tenure and level of pay compared to other top managers.

### Tenure of outgoing CEO

Although appointing a CEO is one of the most important jobs of a board, it does not happen often. Directors may have experienced few successions during their service. Lorsch and Khurana (1989: 64) quote a director as saying, 'The most important role that the board plays is selecting the CEO. It doesn't happen very often, so it isn't a regular responsibility, but it's a very important one.'

Combining an infrequent decision with the lag between appointment and evaluation of a CEO's performance makes learning and applying lessons across CEO successions very difficult (Einhorn and Hogarth, 1981; Kesner and Sebora, 1994). Thus, it follows that the longer the tenure of an outgoing CEO, the less likely it is that members of that board have been involved in a CEO succession. Directors will be less certain regarding shareholder reaction, which makes their decision more risky. If the outgoing CEO has been in office only a short time, directors would have recent experience that they could use. In such cases, directors may have learned from some mistakes and thus be more confident in their selection of the incoming CEO (Einhorn and Hogarth, 1981). Even if directors have experience with CEO succession through other directorships, firm-specific issues that influence shareholder reaction to CEO succession suggest that this experience elsewhere may not reduce their uncertainty regarding negative shareholder reaction at another firm.

Further, CEOs with longer tenure are likely to be identified with the firm, and also are likely to have experienced some significant positive outcomes. The 'romance of leadership' (Meindl *et al.*, 1985) suggests external observers may link positive outcomes directly to the CEO, and replacing him or her will be fraught with uncertainty. Indeed, the longer the CEO's tenure, the more likely he or she will have been successful (Finkelstein *et al.*, 2009). Similarly, the more tightly linked the CEO is to the firm, the greater a board's uncertainty about shareholder reaction to the successor. All these factors represented by long-tenured CEOs

would exacerbate uncertainty regarding the market's response to a new CEO, so we hypothesize:

*Hypothesis 2: Tenure of the outgoing CEO will be positively related to the likelihood of a noisy CEO succession event.*

#### *Pay gap between outgoing CEO and top managers*

Researchers suggest that the pay gap between a CEO and other top managers indicates the relative importance of the CEO to the firm (Bebchuk, Cremers, and Peyer, 2006). Tournament theorists argue that wide economic differences across managerial ranks motivate otherwise risk-averse and difficult-to-monitor executives to work hard and to compete in a contest with only one eventual winner (see Lazear and Rosen, 1981; Rosen, 1986). These same theorists also argue that firm-level conditions may influence the extent of the gap in pay between the CEO and other executives (i.e., the size of the prize). For example, Lazear (1989) theorizes that wide economic differences among managers might work best when there is little task interdependence in the management team and when the CEO is more autonomous in decision making. Research also indicates that CEOs accumulate positive media attention, and that the pay gap between star CEOs and other managers will widen (Graffin *et al.*, 2008). An increasing gap in pay may occur either because board members positively reward star CEOs for the quality-signaling aspect of this media coverage (Wade *et al.*, 2006), or because CEOs take advantage of media attention to consolidate their power and assume more control of the firm (Graffin *et al.*, 2008; Hayward, Rindova, and Pollock, 2004).

These studies all suggest that the pay of the CEO compared to other top managers is an indicator of the 'relative significance of the CEO in terms of abilities, contribution, or power' (Bebchuk, Cremers, and Peyer, 2006: 1), or the degree to which a CEO dominates a firm (Hambrick and D'Aveni, 1992). This means that as the pay gap grows, the new CEO simply has bigger shoes to fill. As a director we interviewed noted:

*Well, if the prior CEO was great, then I'm guessing the market would be skeptical of anyone new that we appointed.*

As an outgoing CEO's relative stature in a firm grows, directors will be more uncertain as to how

shareholders will respond to a replacement, and will be more likely to introduce strategic noise. Thus, we hypothesize:

*Hypothesis 3: The gap in pay between the outgoing CEO and the rest of the top management team will be positively related to the likelihood of a noisy CEO succession event.*

#### **Firm-level characteristics**

Our theory also takes into account the effects of firm-level characteristics. Specifically, firm-level managerial discretion and prior stock market performance may influence the likelihood that strategic noise will be introduced into CEO succession.

#### *Firm-level managerial discretion*

*Managerial discretion* is defined as the latitude for action or range of strategic options that executives have at their disposal (Hambrick and Abrahamson, 1995). Research suggests that levels of discretion vary across firms and industries; CEOs of high-discretion firms should have more opportunity to influence firm-level outcomes than CEOs of low-discretion firms (Finkelstein and Boyd, 1998).

The greater the amount of discretion at a firm, the greater the amount of influence a CEO has on organizational outcomes (Hambrick and Finkelstein, 1987). Consistent with the idea that CEOs are more valuable for high-discretion firms, studies show a consistent positive relationship between managerial discretion and CEO compensation (see Finkelstein and Boyd, 1998; Sanders and Carpenter, 1998). At the same time, CEO turnover in low-discretion firms may be less important because such firms are characterized by strategic stability, and firm performance is influenced by changes in the environment more than firm-level decisions (Hambrick and Finkelstein, 1987). Reinganum (1985) finds that the announcement of a CEO succession affects the stock prices of high-discretion firms more than those of low-discretion firms.

Therefore, in high-discretion firms, CEO succession may be viewed as more critical than in low-discretion firms, as CEOs have greater impact in the former. While we do not assert that shareholder reaction to a CEO succession in a high-discretion firm will necessarily be more negative, we do expect the reaction will be more uncertain. This

uncertainty will provide boards with more incentive to create strategic noise in higher-discretion contexts. Thus we hypothesize:

*Hypothesis 4: Firm-level managerial discretion will be positively related to the likelihood of a noisy CEO succession event.*

### *Recent firm performance*

Recent firm performance is one of the most important elements, if not *the* most important element, affecting shareholder interpretation of CEO succession (e.g. Finkelstein *et al.*, 2009: 164–226; Friedman and Singh, 1989; Shen and Cannella, 2003). Firm performance is the primary metric applied to assess CEO quality (Khurana, 2002). If a firm's recent stock performance has been strong, this suggests shareholders are pleased with the current state of the firm, and it is likely that a great deal of this success will be attributed to the outgoing CEO (Meindl *et al.*, 1985).

At the extreme, some CEOs of successful firms are seen as stars (Wade *et al.*, 2006). Firm performance is strongly associated with their celebrity, creating considerable uncertainty and providing incentive for directors to inject strategic noise into the succession process (Hayward *et al.*, 2004). If firm stock performance has been poor, however, investors may look for CEO turnover. To the extent that negative performance leads to shareholder dissatisfaction, the current CEO is in for blame (Gamson and Scotch, 1964). Negative feelings about the quality of the CEO would dampen strategic noise, as directors would want to be seen as ridding the organization of a poor CEO. In this case, the board may wish to make it quite clear that they are fulfilling their duty to monitor and replace the CEO. Thus, we hypothesize:

*Hypothesis 5: Recent firm stock performance will be positively related to the likelihood of a noisy CEO succession event.*

### **Incoming CEO characteristics**

The characteristics of the incoming CEO may affect the likelihood of a noisy CEO succession.<sup>3</sup> We examine characteristics that influence how

much a new CEO may be perceived as being prepared to act: CEO experience and age, and the reputation of his or her last firm.

### *Previous experience as CEO*

The CEO position differs significantly from all others (Kesner and Sebora, 1994). If the appointee has never served as a CEO, shareholders may be concerned that he or she is not prepared to handle the new responsibilities. As one director we interviewed stated:

*Our successor had never been a CEO before, so we were concerned that the market would not understand why we chose her.*

If the appointee has previously served as a CEO, this may signal to shareholders the ability to lead from day one. Previous CEO experience may not only legitimate the selection (Khurana, 2002) but may also mean the person is generally known and thus may be a less uncertain or less risky choice. Thus, we hypothesize:

*Hypothesis 6: Prior CEO experience will be negatively related to the likelihood of a noisy CEO succession event.*

### *Incoming CEO age*

Another observable characteristic that may influence external perceptions of the qualifications of a new CEO is the appointee's age at the time of appointment. Boards could be concerned shareholders will react negatively to the appointment of a relatively young CEO. A young CEO may not be viewed as having the breadth and depth of experience of an older candidate. The director quoted above also noted in other comments that the new CEO was relatively young. Organization leaders may be particularly uncertain about shareholder reaction in this case. We thus hypothesize:

*Hypothesis 7: Age of the incoming CEO will be negatively related to the likelihood of a noisy CEO succession event.*

### *Reputation of an incoming CEO's home firm*

The third characteristic of the incoming CEO that we consider is whether a person hired from outside the organization comes from a firm that has

<sup>3</sup> We thank one of our anonymous *SMJ* reviewers for suggesting the variables examined in Hypotheses 6–8.

a strong, positive reputation. Experience in a firm held in high regard may be an important informational cue for investors. A key determinant of a candidate's legitimacy is the reputation of his or her firm (Khurana, 2002). Graffin *et al.* (2008) report that top executives affiliated with a star CEO were more likely to be appointed CEOs elsewhere. Organization leaders likely take into account the reputation of the sending firm when they consider how shareholders may react to a succession announcement. We thus hypothesize:

*Hypothesis 8: The appointment of a CEO from a high- (positive) reputation firm will be negatively related to the likelihood of a noisy CEO succession event.*

## METHODS

### Sample and data collection

The sample consists of all CEO successions for *Fortune* 1000 firms over 1999–2004. We found the dates CEOs were named by searching firm press releases using PR Newswire and LexisNexis. During the period, 631 successions took place, but missing data reduced the sample to 623 firms. The final sample was 601 firms, with the exclusion of 22 firms that experienced exogenous confounding events not entirely under the control of the firm.

We used the press releases to assess whether a given CEO succession was confounded as well as to establish a baseline confounding rate to test Hypothesis 1. Data on firm size, firm performance, and industry performance came from Compustat. Data on director characteristics were collected from RiskMetrics (formerly IRRC) and proxy statements filed with the Securities and Exchange Commission (SEC). We obtained data on executive characteristics, pay, and managerial discretion from Compustat, Zoominfo.com, and from *Forbes'* annual survey of executive compensation.

### Measures

#### Strategic noise

We coded that *strategic noise* was present if three criteria are met at the time of a CEO succession: 1) the firm must have announced a confounding event within  $+/-1$  day of the CEO succession announcement; 2) the confounding event must

have been completely under the control of the firm; and 3) the confounding event must not have been intended to clarify the CEO succession and it must not be causally related to the CEO succession.

Following other studies, we defined a confounding event as any significant organizational occurrence that could influence a firm's stock price and that occurred within  $+/-1$  day of the CEO succession (McWilliams and Siegel, 1997). Examples of confounding events are changes in dividend rates, earnings announcements, and changes in key executives. As our interest was in CEO successions strategically confounded by firms themselves, we confined our coding to confounding events that were entirely within the control of the firm. CEO successions that were confounded by events that were not entirely under the firm's control, such as announcements related to acquisitions or lawsuits, were excluded from all analyses (22). This gave us 134 cases of firm-controlled confounding events announced within  $+/-1$  day of a CEO appointment.

Finally, as our intent was to capture only confounds that allow the firm to plausibly manage negative market reactions, we did not want to include releases if the release was causally related to a CEO succession. We instructed two coders to read all confounding releases and code whether or not the release helped to explain or was causally related to the CEO succession. The coders independently coded all releases, and then upon discussion of all releases agreed that 14 releases were intended to clarify or were causally related to the CEO succession. Accordingly, those 14 CEO successions were not coded as strategic noise.

This left 120 CEO successions, or 20 percent of the sample that met all three criteria. Confounding announcements included: earnings releases (57), earnings restatements or guidance (14), plans for stock buy-backs or splits (10), changes in the dividend rate (10), plans to divest a business or close a plant (9), or other reasons (20).<sup>4</sup>

#### Baseline confounding rate

Our first step was to determine whether strategic noise surrounding CEO successions occurred

<sup>4</sup> Examples of confounding events in the 'other' category include: new product launches, plans to file or emerge from bankruptcy, issuance of debt, change in executive or director pay, and the retirement of other key executives.

Table 1. Calculation of baseline confounding rate<sup>6</sup>

Group	N	Confounds per firm			ICC (2, 2)
		Rater 1	Rater 2	Average	
Firms where CEO succession was not confounded 3 days in event window (-1, 0, +1)	50	9.46	9.84	9.65 3	0.97
Maximum number of days confounded				28.95	
Confound baseline rate (max. days confounded/250)				11.5%	
Firms where CEO succession was confounded 3 days in event window (-1, 0, +1)	50	9.48	9.24	9.36 3	0.97
Maximum number of days confounded				28.08	
Confound baseline rate (max. days confounded/250)				11.2%	
Combined Groups 3 Days in event window (-1, 0, +1)	100	9.47	9.54	9.51 3	0.97
Maximum number of days confounded				28.52	
Confound baseline rate (max. days confounded/250)				11.4%	

at a rate higher than one would expect if strategic noise occurred randomly. We are interested in answering two main questions. First, how many firm announcements occur annually for firms experiencing a CEO succession? Second, how likely is it that these announcements will occur simultaneously or within a short window?

To answer the first question, we calculated a *baseline confound rate* by examining all possible confounding events in press releases from two subsamples of firms. Table 1 provides calculation details.<sup>5</sup> We generated a subsample of 50 randomly selected firms where the CEO succession event was not confounded and a subsample of 50 randomly selected firms where the CEO succession was confounded. For each subsample, two raters examined all press releases for one year surrounding the CEO succession for each firm and counted the number of significant organizational occurrences where the release of information about the occurrence was controlled by the organization. We assessed the reliability of our raters using the intraclass correlation coefficient (ICC) (2, k) (Shrout and Fleiss, 1979). Using ICC (2, k) the reliability for the subsample with nonconfounded CEO successions is 0.97, which suggests that the measures can be aggregated (Trevor and Nyberg, 2008). The average annual number of significant

organizational occurrences per firm in this subsample is 9.65.

Once we had established the average number of significant organizational occurrences per firm in a given year, the next step was to determine the likelihood that any given announcement by a firm would be confounded by the release of a concurrent significant organizational event. This is an attempt to answer our second question: what is the likelihood that these announcements would be clustered together?

To establish the baseline rate that represents the rate at which events should be confounded by chance, we multiplied the average number of significant organizational occurrences per year, 9.65, by 3 to generate the maximum number of event-window days that these events could confound (as we looked for confounding events for the three-day window starting on day -1 and ending with day +1 around the CEO succession announcement). This calculation resulted in a baseline confounding rate of 11.5 percent [(9.65 × 3)/250], assuming an average of 250 trading days per year. This rate indicates that if a firm announced a significant organizational event on a random day, the likelihood that it will be confounded by another significant announcement within that three-day window is 11.5 percent.

As firms where CEO successions are confounded may differ from firms where they are not, we

<sup>5</sup> Initially, we considered comparing the number of confounds in our sample with the number of confounds in other event study research. We abandoned this approach because we are arguing that some confounding announcements are made in a strategic fashion and are purposeful. If we were to compare our sample with other event study research, we would potentially be comparing a sample that had both purposeful and random confounds.

<sup>6</sup> All firms considered in this table experienced a CEO succession and confounds were gathered for the year surrounding the succession. Coders were instructed to count all confounding events that were completely under the control of the firm.

performed the same calculations on a second subsample. Two coders examined the press releases for one year surrounding CEO successions for a random sample of 50 firms within our sample where the CEO succession was confounded. Once again, we employed ICC (2, k), and the reliability of the two raters was also very high (0.97), suggesting aggregation of the raters was appropriate. These firms experienced an average of 9.36 significant organizational events in the year surrounding the CEO succession. Using the same process as above, the baseline confounding rate for this subsample is 11.2 percent [9.36 × 3/250].

#### *Outgoing CEO tenure*

CEO tenure was calculated as the number of years of tenure for the outgoing CEO. This variable was lagged one year in all analyses.

#### *Outgoing CEO-top management pay gap*

Following Carpenter and Sanders (2004) and Graffin *et al.* (2008), we computed the gap between the pay of the CEO and other top management team members by logging the difference between the CEO's total direct compensation (tdc1 in Execucomp) and the average total direct compensation of the other listed executives.<sup>7</sup>

In a few firms, the difference was actually negative. Because we logged this measure, we set the value of negative differences to 1. This transformation had no effect on the significance or sign of any values in our analyses, and our results are unchanged when we recalculate the models after dropping these firms from our sample. This variable was lagged one year in all analyses.

#### *Company market performance*

We used a measure of compounded market returns that consists of a firm's yearly stock returns, assuming reinvestment of dividends ((Price<sub>beg</sub> - Price<sub>end</sub> + Dividends)/Price<sub>beg</sub>). This measure was lagged one year in all analyses. Stock market performance, more directly than accounting performance, captures assessments that inform how risky

<sup>7</sup> When we calculate pay gap using a variable that represents the difference between the CEO and the second-highest paid manager, the results are largely unchanged.

or uncertain a CEO succession may be in the minds of directors.

#### *Managerial discretion*

We used five indicators that have been used in other studies to measure a CEO's firm-level discretion (e.g., Hambrick and Abrahamson, 1995; Finkelstein and Boyd, 1998) over the five years preceding a firm's CEO succession (for instance, if a CEO succession occurred in 1999, we calculated managerial discretion over the years 1994–1998). We measured market growth as the average annual percentage change in firm sales, and demand instability as the standard deviation of the annual change in firm sales. Discretion researchers consider managerial discretion to be higher in growing businesses where demand varies yearly.

To capture the degree to which a firm followed a differentiation strategy, we measured average annual research and development intensity (R&D/sales) and average annual advertising intensity (advertising/sales). The final indicator was average annual capital intensity, which we measured by dividing the net value of property, plant, and equipment by the number of employees and then multiplying this product by -1 so that lower scores are associated with less discretion. Capital-intensive businesses are likely to constrain managerial choices, given that a required investment in fixed assets commits the firm to a course of action. Standardization and summation of these five measures provided an overall measure of firm discretion.

#### *Previous CEO experience*

We constructed a dummy variable that takes a value of 1 if the newly appointed CEO had previously served as a CEO and 0 otherwise. To construct this measure, we first read the press release announcing the CEO appointment. Most press releases included detailed biographies for the newly appointed CEOs. When a biography was not included we searched the Execucomp database for executive work histories.

Following Graffin *et al.* (2008), who also tracked executive careers, we also searched Zoominfo.com for executive work histories. According to its Web site, Zoominfo.com provides: 'comprehensive information on over 33 million business professionals and 2 million companies across virtually

every industry.' If no information was found indicating that the newly appointed executive had previously served as a CEO, we coded the individual as 0.

#### *CEO age*

CEO age was measured at the time the individual was announced as the new CEO. We obtained this information from Execucomp. For missing values, we searched the press release announcing the CEO succession and performed Internet searches.

#### *Reputation of an outside CEO's firm*

We obtained data on a firm's reputation using the *Fortune* Most-Admired (FMA) rankings (see Basdeo *et al.*, 2006; Fombrun and Shanley, 1990; Love and Kraatz, 2009), as well as the *Wall Street Journal/Harris Interactive* Corporate Reputation (WSJ) list (Gardberg and Fombrun, 2002). We combined the lists because *Fortune* listed only the top 10 firms in an industry in 1998, and only the top 20 firms between 1999 and 2004. Of the 25 different firms listed in the FMA top-10/top-20 list between 1999 and 2004, 22 were also named in the WSJ top 25, showing strong overlap between the two lists.

We then counted the number of times firms appeared on either list for the five years preceding our sample. Capturing a five-year rolling total of such rankings is consistent with other studies that have controlled for an individual or firm's accumulated reputation (e.g., Graffin *et al.*, 2008; Wade *et al.*, 2006). In all, 27 of the 143 outside CEO successions involve people hired from firms that appeared on either list in the five years preceding the CEO succession.<sup>8</sup>

#### **Control variables**

We controlled for a number of firm- and industry-level factors. First, we controlled for whether the outgoing CEO also held the title of chair of the board using a dummy variable. Second, we controlled for the percentage of outside directors on the board and the total number of directors on the board. These variables were lagged in all analyses.

<sup>8</sup> Results and conclusions are substantially the same when we use a dummy variable that takes a value of 1 if a firm appeared on either of these lists in the five years preceding the CEO succession and 0 otherwise.

We also controlled for whether or not the announcement of the incoming CEO occurred simultaneously with the announcement of the outgoing CEO stepping down. This dummy variable takes a value of 1 when the announcements are made simultaneously and 0 otherwise. In our sample, 92 percent of the CEO succession announcements were made simultaneously. Results using the departure announcement produce substantially the same conclusion.

Because dismissal represents a unique type of CEO succession (Finkelstein *et al.*, 2009), we included a dummy variable indicating a CEO was fired. We created this variable by applying the criteria developed by Shen and Cannella (2002) (i.e., a dismissal occurred when the outgoing CEO was less than 65 years old and did not retain a seat on the board).

We also controlled for whether the CEO succession was a relay succession. Relay successions occur when a sitting CEO works with and presumably grooms an 'heir apparent,' and passes the baton of leadership to this heir in an orderly manner (Cannella and Lubatkin, 1993; Vancil, 1987). CEO successions were coded as relay successions when the individual promoted held the title of president and/or chief operating officer prior to being named CEO.

We also created a variable coded as 1 when the incoming CEO was hired from outside the firm and 0 when he or she was promoted internally. Outside successions are defined as those in which the incoming CEO was hired from outside the firm or had been employed for two years or less (as some CEOs receive some on-the-job training before promotion) (Cannella and Lubatkin, 1993; Harris and Helfat, 1997). A wide range of outcomes have been associated with this variable (see Finkelstein, *et al.*, 2009: 164–226, for a review).

We controlled for firms' annual return on equity (ROE), which measures how well a company is using the equity provided by stockholders (Teitelman, 1996). We also controlled for the industry average market return and ROE. We defined a firm's industry as all other public companies that share the same two-digit standard industrial classification code. Past research has found that the two-digit level captures most of the systematic industry variation in stock prices (Clarke, 1989). Moreover, research suggests that corporate boards make performance comparisons at the two-digit level (e.g., Gibbons and Murphy, 1990).

Industry market performance was calculated using the formula  $\sum_{ij} (\text{Total Assets}_{ij} \times \text{Total Return}_{ij}) / (\sum_{ij} \text{Total Assets}_{ij})$ , where  $i$  indicates each company in industry  $j$  for a given year (industry return on equity is calculated in a similar way). Investors may use the relative stock market return to assess the quality of the contribution of both the CEO and the board members. Like other researchers we also controlled for firm size, using the log of firms' sales. These variables were lagged in all analyses.

We created a variable that takes a value of 1 when the outgoing CEO was the founder of the company and 0 otherwise. Another variable takes a value of 1 when the outgoing CEO remains on the board following the CEO succession and 0 otherwise. We also controlled for the outgoing CEO's total stock holdings at the time of the CEO succession. Finally, dummy variables for the years 1999–2003, with 2004 as the omitted value, were included to control for any period effects in our panel data.

## Analysis

We tested Hypothesis 1 by comparing the actual rate at which CEO successions were confounded in our sample to the calculated baseline confounding rates using the z-test for two proportions. The remaining hypotheses were tested using logistic regression, because whether or not a CEO succession is confounded is a dichotomous outcome. As such, the dependent variable has an S-shaped association with its predictors that violates the assumption of linearity in other regression models (Liao, 1994). Standard errors were clustered by firm, as some firms in our sample experienced multiple CEO successions.

We conducted extensive additional analyses in order to rule out potential alternative explanations. We have identified three major possible alternative explanations that might result in similar effects. First, it is possible that the announcement of confounding events, while nonrandom, is merely an administrative artifact. For instance, firms may release changes in earnings forecasts and announce other significant events such as CEO changes right after board meetings. If this were the case, then CEO succession events would be confounded at rates higher than chance, but this noise would not be strategic in nature and would not occur in a systematic manner. Hypotheses 2–8 help rule out this

particular alternative explanation, because if these announcements were merely the result of board processes, our predictors would not be expected to be significant. Thus, support for Hypotheses 2–8 provides support for our claim that the release of other significant events is strategic in nature and not merely an administrative artifact.

Second, it is possible that the announcement of confounding events is nonrandom and that the release of confounding information is merely an artifact of the CEO succession process itself. Indeed, it is possible that the same factors that make a firm more likely to replace its CEO also make it more likely to release certain types of information. To rule out this explanation, we ran a two-stage Heckman model using a matched-pair sample of firms (matched on sales volume and year) that did not experience a CEO succession. In the first stage, we predict CEO succession using our independent and control variables. In the second stage, we included the firm's likelihood of experiencing a succession event as a control variable. This procedure controls for a firm's likelihood of undergoing a succession event when predicting the likelihood that the firm's succession was also confounded. Because the results and conclusions of the two-stage model were similar, we report results for the simpler models in Table 3.

Third, it is possible that firms intentionally release information at the same time as the announcement of the CEO succession in order to 'clean house.' A board and a CEO might want to release all negative information quickly in order to get potential hits to the stock price behind them. To rule out this alternative explanation, we asked two raters to code whether each confounding event was positive, neutral, or negative. We found that only a minority of confounding events were negative (21 of 120), while the majority were either positive (66 of 120) or neutral (33 of 120) in tone.

## RESULTS

Descriptive statistics and bivariate correlations are displayed in Table 2. To test Hypothesis 1, which asserts that CEO succession will be confounded at a higher rate than expected by chance, we performed a z-test to compare the actual rate at which successions were confounded and the baseline confound rate. We compared the actual rate (20.0%) to the baseline confounding rate for both subsamples

Table 2. Correlations and descriptive statistics\*

Variable	Var	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27
CEO SUCCESSION	1	0.20	0.40	1.00																										
CONFOUNDED																														
Return on equity	2	6.12	94.94	0.03	1.00																									
Industry market performance	3	26.71	62.46	0.11	0.15	1.00																								
Industry return on equity	4	8.82	25.83	-0.02	0.07	0.03	1.00																							
Firm sales (\$ millions, logged)	5	8.40	1.08	-0.03	0.09	0.03	0.00	1.00																						
1999 dummy	6	0.18	0.38	0.01	0.03	-0.02	0.08	0.02	1.00																					
2000 dummy	7	0.15	0.36	-0.03	0.08	-0.05	0.10	0.04	-0.20	1.00																				
2001 dummy	8	0.17	0.37	-0.02	-0.10	-0.06	-0.09	0.02	-0.22	-0.19	1.00																			
2002 dummy	9	0.16	0.37	0.00	-0.10	-0.07	-0.14	-0.02	-0.21	-0.19	-0.20	1.00																		
2003 dummy	10	0.14	0.34	-0.04	0.03	0.16	-0.04	-0.02	-0.19	-0.17	-0.18	-0.17	1.00																	
Incoming CEO hired from outside	11	0.24	0.43	-0.07	-0.07	-0.02	0.01	-0.04	0.02	0.09	-0.06	-0.03	0.04	1.00																
Relay succession	12	0.50	0.50	0.09	0.04	0.04	0.05	-0.01	-0.03	0.05	-0.02	-0.04	-0.06	-0.36	1.00															
Outgoing CEO was dismissed	13	0.11	0.31	-0.05	-0.01	-0.03	-0.05	0.05	0.13	-0.05	0.02	0.00	-0.14	0.06	-0.25	1.00														
Outgoing CEO duality	14	0.75	0.44	0.06	-0.05	0.03	-0.02	0.10	-0.05	0.01	-0.04	0.03	0.07	0.00	0.12	-0.09	1.00													
Percent of outside directors on board	15	0.80	0.11	-0.05	0.03	-0.01	-0.03	0.17	-0.09	0.03	0.01	0.07	0.09	0.11	-0.08	0.05	0.02	1.00												
Total directors on board	16	10.72	2.82	0.01	0.14	0.00	0.06	0.36	0.08	0.05	-0.07	-0.07	-0.02	-0.01	-0.03	-0.04	-0.06	0.14	1.00											
Simultaneous announcement	17	0.92	0.26	0.08	0.04	0.01	-0.01	-0.06	0.08	0.00	-0.01	-0.01	-0.07	0.13	0.04	0.04	-0.04	-0.08	0.00	1.00										
Outgoing CEO on board	18	0.68	0.47	0.01	0.09	0.04	0.13	-0.07	0.07	0.02	-0.02	-0.07	-0.01	0.10	0.27	-0.33	0.21	-0.13	-0.02	0.00	1.00									
Outgoing CEO founder	19	0.06	0.23	0.05	0.02	-0.02	0.03	-0.02	0.01	0.03	0.02	-0.03	0.00	0.03	0.04	-0.07	0.10	-0.12	-0.14	0.07	0.09	1.00								
Outgoing CEO shares (logged)	20	5.83	2.23	0.01	-0.06	0.05	0.06	0.19	0.01	-0.03	0.07	-0.03	0.05	0.02	0.04	0.02	0.15	-0.15	-0.07	0.06	0.07	0.28	1.00							
Outgoing CEO tenure	21	8.53	7.38	0.12	0.00	-0.03	0.03	-0.02	0.01	0.00	0.02	-0.04	-0.02	0.10	-0.13	0.19	-0.15	-0.03	0.07	0.14	0.30	1.00								
Pay gap (\$000s, logged)	22	7.53	1.82	0.06	0.04	0.01	0.01	0.33	0.02	-0.02	0.01	0.05	0.00	0.00	-0.04	0.13	0.07	0.19	0.21	-0.03	-0.10	-0.09	0.02	-0.07	1.00					
Managerial discretion	23	0.00	0.45	0.00	0.02	0.07	0.10	0.36	0.11	0.01	-0.09	0.00	-0.03	0.05	0.03	0.01	-0.00	0.01	0.09	-0.04	0.00	0.01	0.14	0.03	0.21	1.00				
Company market performance	24	4.64	58.79	0.11	0.10	0.14	0.13	-0.10	0.01	0.05	-0.05	-0.22	-0.22	0.12	-0.16	0.06	-0.12	-0.04	0.00	0.12	0.01	0.06	0.08	0.03	0.08	1.00				
CEO experience	25	0.17	0.38	-0.10	-0.08	0.00	-0.05	0.07	-0.01	0.10	0.03	0.00	0.32	-0.27	0.14	-0.06	0.04	-0.01	-0.05	-0.25	0.06	0.01	-0.06	0.10	0.02	-0.13	1.00			
Incoming CEO age	26	51.62	6.32	0.02	0.00	-0.03	-0.01	0.08	0.03	0.01	-0.03	0.02	0.05	-0.02	-0.14	0.69	-0.03	0.08	0.08	-0.15	-0.01	-0.01	0.06	0.00	-0.08	0.27	1.00			
Outside CEO home firm reputation	27	0.14	0.73	-0.09	-0.01	0.05	0.02	-0.02	0.05	-0.04	-0.01	-0.06	0.09	0.36	-0.16	0.09	-0.06	-0.02	0.01	-0.69	0.04	0.06	0.00	0.01	0.05	-0.04	0.11	1.00		

\* n = 601, p &lt;= 0.05 for correlations greater than 0.07.

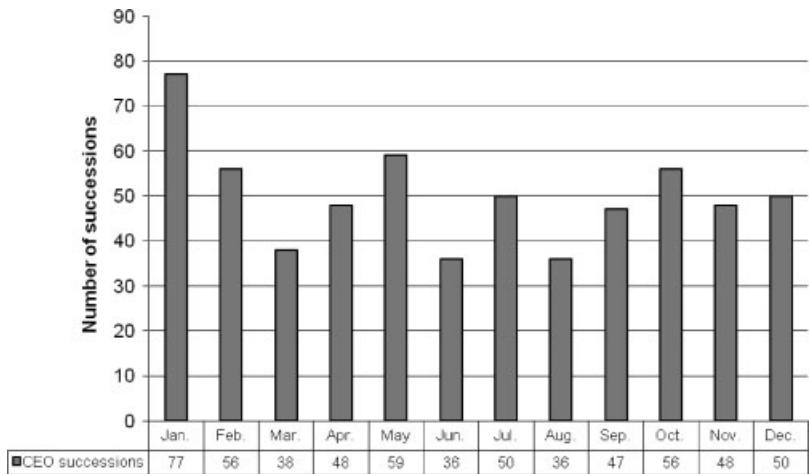


Figure 2. CEO successions by month, 1999–2004

(i.e., firms where CEO succession was not confounded, 11.5% and firms where CEO succession was confounded, 11.2%) and for the combined group (11.4%). In each case the difference is statistically significant ( $z = 2.16$ ;  $p < 0.05$ ), ( $z = 2.26$ ;  $p < 0.05$ ),<sup>9</sup> and ( $z = 2.94$ ;  $p < 0.01$ ) respectively.

As a robustness check, we collected confounding events for a matched-pair sample of 100 firms, based upon industry, sales, and year, that did not experience a CEO succession. The confounding rate for this sample was 10.9 percent. Once again, the difference between this rate and the actual confounding rate is statistically significant (2.16;  $p < 0.05$ ).

To better rule out the alternative explanation that all significant firm announcements may be confounded at a higher rate than would be expected by random chance (i.e., higher than the baseline confounding rate), we also compared the rate at which CEO successions were confounded in our sample to the rate at which earning announcements are confounded. Pfarrer, Pollock, and Rindova (2008) performed event studies to examine shareholder reactions to earnings announcements. In a sample of 291 firms over 15 years, 184 of 1,524 of earnings announcements (11.9%) were confounded within  $+/-1$  day.

With this confound rate as a basis of comparison, we found that CEO successions were confounded at a statistically significant higher rate than earnings announcements ( $z = 4.86$ ;  $p < 0.01$ ). It is

also worth noting that the overall baseline confounding rate of 11.4 percent that we calculated was not statistically significantly different from the confounding rate in Pfarrer *et al.* (2008) ( $z = 0.23$ ;  $p > 0.40$ ).

These results provide robust support for Hypothesis 1. It is still possible that the higher than expected confound rate of CEO succession is the result of an administrative artifact, as all significant announcements may simply be released as a batch every quarter. While Hypotheses 2–8 test arguments that, if supported, are counter to this explanation, we also examined the distribution of CEO successions to learn if the vast majority of them occur at the end of every quarter, or if the successions are spread out through the year. Figure 2 lists CEO successions by month. We see that, while January is the most common month, CEO successions occur throughout the year.

Table 3 provides the results of the logistic regression models that test Hypotheses 2–8. They examine whether contextual factors impact the likelihood that firms will inject strategic noise into CEO successions.<sup>10</sup> Model 1 is the control model. Models 2–8 test each hypothesis individually, and Model 9 is the full model that includes all independent variables. A hypothesis is considered

<sup>9</sup> Results of the analysis using the announcement that the outgoing CEO is stepping down are substantially similar.

<sup>10</sup> We also reran our models using a count of the number of press releases that qualified as strategic noise as the dependent variable. Our results and conclusions were unchanged when we tested this dependent variable using a negative binomial regression. The mean for this variable was 1.4 with a range of 1–4.

Table 3. Likelihood of CEO succession being confounded†

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
Return on equity (ROE)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.000 (0.001)	0.000 (0.001)	0.000 (0.001)	0.001 (0.001)	0.000 (0.001)
Industry market	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)	0.002** (0.001)
Performance									
Industry ROE	-0.002 (0.004)	-0.002 (0.004)	-0.003 (0.004)	-0.003 (0.004)	-0.003 (0.004)	-0.003 (0.004)	-0.002 (0.004)	-0.003 (0.004)	-0.004 (0.005)
Firm sales (logged)	-0.121 (0.109)	-0.110 (0.111)	-0.170 (0.112)	-0.137 (0.114)	-0.098 (0.109)	-0.099 (0.110)	-0.127 (0.110)	-0.134 (0.111)	-0.131 (0.119)
Relay succession	0.286 (0.234)	0.287 (0.238)	0.282 (0.236)	0.279 (0.235)	0.259 (0.236)	0.243 (0.233)	0.311 (0.236)	0.279 (0.232)	0.226 (0.244)
Outgoing CEO was dismissed	-0.413 (0.420)	-0.340 (0.419)	-0.471 (0.421)	-0.415 (0.421)	-0.339 (0.419)	-0.383 (0.419)	-0.422 (0.419)	-0.337 (0.426)	-0.194 (0.431)
Incoming CEO hired from outside	-0.259 (0.287)	-0.255 (0.290)	-0.254 (0.288)	-0.271 (0.288)	-0.278 (0.291)	-0.125 (0.297)	-0.238 (0.287)	-0.074 (0.296)	0.188 (0.318)
Outgoing CEO duality	0.443 (0.284)	0.378 (0.284)	0.407 (0.287)	0.450 (0.282)	0.421 (0.288)	0.429 (0.285)	0.449 (0.284)	0.415 (0.283)	0.269 (0.293)
Percent of Outside Directors on Board	-0.458 (0.989)	-0.275 (0.996)	-0.664 (1.002)	-0.438 (0.988)	-0.252 (0.987)	-0.535 (1.000)	-0.520 (0.990)	-0.501 (0.986)	-0.609 (1.033)
Total directors on board	0.022 (0.038)	0.019 (0.038)	0.014 (0.039)	0.023 (0.038)	0.024 (0.038)	0.020 (0.038)	0.020 (0.038)	0.026 (0.039)	0.013 (0.039)
Simultaneous Announcement	0.829 (0.538)	0.793 (0.538)	0.824 (0.535)	0.832 (0.538)	0.827 (0.545)	0.822 (0.539)	0.800 (0.541)	0.800 (0.540)	0.666 (0.551)
Outgoing CEO on board	-0.305 (0.258)	-0.329 (0.260)	-0.283 (0.259)	-0.306 (0.258)	-0.311 (0.261)	-0.375 (0.259)	-0.282 (0.260)	-0.251 (0.262)	-0.317 (0.271)
Outgoing CEO founder	0.479 (0.430)	0.287 (0.427)	0.493 (0.430)	0.484 (0.429)	0.541 (0.433)	0.543 (0.441)	0.471 (0.426)	0.512 (0.433)	0.444 (0.445)
Outgoing CEO shares (logged)	-0.010 (0.047)	-0.032 (0.048)	-0.008 (0.047)	-0.012 (0.047)	-0.018 (0.047)	-0.011 (0.048)	-0.010 (0.047)	-0.006 (0.049)	-0.040 (0.050)
1999 dummy	-0.169 (0.333)	-0.163 (0.331)	-0.186 (0.336)	-0.182 (0.334)	-0.204 (0.333)	-0.161 (0.333)	-0.182 (0.333)	-0.154 (0.335)	-0.202 (0.344)
2000 dummy	-0.432 (0.359)	-0.422 (0.360)	-0.429 (0.357)	-0.31 (0.360)	-0.486 (0.363)	-0.375 (0.363)	-0.449 (0.363)	-0.456 (0.359)	-0.431 (0.365)
2001 dummy	-0.259 (0.365)	-0.258 (0.364)	-0.276 (0.363)	-0.251 (0.367)	-0.268 (0.367)	-0.232 (0.367)	-0.257 (0.364)	-0.262 (0.364)	-0.225 (0.367)
2002 dummy	-0.195 (0.344)	-0.167 (0.341)	-0.241 (0.343)	-0.202 (0.341)	-0.120 (0.348)	-0.178 (0.347)	-0.202 (0.344)	-0.199 (0.344)	-0.139 (0.349)
2003 dummy	-0.684* (0.387)	-0.654* (0.387)	-0.703* (0.388)	-0.686* (0.387)	-0.814** (0.391)	-0.675* (0.388)	-0.708* (0.387)	-0.631* (0.383)	-0.740* (0.395)
Outgoing CEO tenure	0.029** (0.015)								0.033** (0.015)
Pay gap (\$000s,logged)			0.121** (0.072)						0.132** (0.078)
Managerial discretion				0.109 (0.231)					0.002 (0.231)
Company market					0.004** (0.002)				0.003** (0.002)
Performance						-0.616** (0.353)			-0.867*** (0.352)
CEO experience							-0.644** (0.373)		-3.144** (0.375)
Incoming CEO age							0.017 (0.017)		0.033** (0.017)
Outside CEO home firm reputation								-0.644** (0.373)	-0.720** (0.375)
Intercept	-0.957 (1.314)	-1.204 (1.321)	-1.190 (1.357)	-0.839 (1.338)	-1.270 (1.334)	-0.925 (1.316)	-1.712 (1.454)	-0.891 (1.304)	-3.144** (1.589)
Observations	601	601	601	601	601	601	601	601	601
Chi <sup>2</sup> (degrees of freedom)	24.64 (19)	29.43 (20)	28.97 (20)	24.92 (20)	29.47 (20)	26.66 (20)	25.04 (20)	22.70 (20)	47.05 (26)
Log likelihood	-287.54	-285.56	-285.96	-287.44	-285.30	-285.95	-287.06	-285.26	-276.15

\* = p &lt; 0.10, \*\* = p &lt; 0.05, \*\*\* = p &lt; 0.01; z statistics are one-tailed for hypothesized effects, two-tailed for control variables.

† Standard errors are in parentheses.

supported if results are robust across the single hypothesis variable and full models.

Hypothesis 2, which predicts that outgoing CEO tenure is positively associated with the likelihood that a CEO succession will be noisy, received support, as the coefficients for outgoing CEO tenure in Models 2 ( $p < 0.05$ ) and 9 ( $p < 0.05$ ) were positive and statistically significant. The practical impact of this finding is that when CEO tenure rises from the mean of our sample to one standard deviation above the mean, the likelihood that the CEO succession is noisy increases by 22 percent (from 17.4% to 21.2%).

Hypothesis 3, which posits that the pay gap between the outgoing CEO and the top management team is positively associated with the likelihood that a CEO succession will be noisy, received support. The coefficients in Model 3 ( $p < 0.05$ ) and Model 9 ( $p < 0.05$ ) were positive and statistically significant. The results suggest that when the pay gap increases from the mean of our sample to one standard deviation above the mean, the likelihood that the CEO succession is noisy increases by 21 percent (from 17.4% to 21.1%).

Hypothesis 4, which suggests that firm-level managerial discretion is positively associated with the likelihood that a CEO succession will be noisy, was not supported, as the coefficient for managerial discretion was not significant in either Model 4 or Model 9. Hypothesis 5, which predicts that company market performance is positively associated with the likelihood that a CEO succession will be noisy, received support, as the coefficients in Model 5 ( $p < 0.05$ ) and Model 9 ( $p < 0.05$ ) were positive and statistically significant. When market performance improves from the mean of our sample to one standard deviation above the mean, the likelihood that the CEO succession is confounded increases by 16 percent (from 17.4% to 20.2%).

Hypothesis 6, which asserts that prior CEO experience is negatively associated with the likelihood that CEO succession will be noisy, was supported in that the coefficients for CEO experience in Model 6 ( $p < 0.05$ ) and Model 9 ( $p < 0.01$ ) were negative and statistically significant. If the appointee previously served as CEO, the likelihood that strategic noise will be injected drops by 52.6 percent compared to the appointee who had not been a CEO (9.3% versus 19.6%).

Hypothesis 7, which posits that incoming CEO age will be negatively related to the likelihood of a noisy CEO succession, was not supported,

as the coefficient for incoming CEO age was not significant in Model 7; it was significant but in the opposite direction in Model 9.

Finally, Hypothesis 8 predicts that when a CEO is hired from a firm with a strong reputation, the likelihood that strategic noise will be injected into the CEO succession process is reduced. This hypothesis was supported: the coefficients for this measure in Model 8 ( $p < 0.05$ ) and Model 9 ( $p < 0.05$ ) were negative and statistically significant. If the incoming CEO is hired from a firm that appeared on the high-reputation list once in the previous five years, the likelihood that strategic noise will be injected drops by 46.1 percent compared to when a new CEO is not hired from such a firm (10.2% versus 18.9%).

Overall, this pattern of results provides support for our contention that the context surrounding CEO succession will influence the level of strategic noise, and hence the likelihood that a CEO succession will be confounded. This pattern of results also largely refutes the alternative explanation that the higher than expected confound rate of CEO successions is an administrative artifact.

## DISCUSSION

Our primary objective has been to develop and test a theory of strategic noise—that is, anticipatory impression management whereby firms' leaders may inject strategic noise at the time that a significant organizational event is announced. We believe that this objective was largely achieved. Specifically, we examined if and when organizations may engage in a previously unexplored type of impression management called anticipatory obfuscation (Elsbach *et al.*, 1998). We find broad empirical support for our theory as to when and where firm leadership might attempt to influence the informational context surrounding key events. The motivation appears to be better characterized as obfuscation rather than as clarification.

Our theory suggests that succession announcements and other events may be related, while other authors have intentionally or unintentionally separated them. The prevailing event study view is that these other occurrences are confounds that call for their exclusion from a study. We suggest instead that firms are likely to inject strategic noise and that numerous CEO appointments are confounded with other significant announcements, in order to

make an organizational situation less transparent and consequently more difficult to analyze.

Our theory also suggests that organizations create strategic noise, not out of malevolence, but simply because of uncertainty as to how the stock market will react to CEO announcements. On this point, we find CEO successions to be confounded at nearly twice the rate that would be expected by chance. Elsbach *et al.* (1998) suggest that organizations may engage in anticipatory obfuscation when events are ambiguously negative (i.e., in our case, when shareholder reaction is potentially negative); and we believe this study is the first to empirically examine this particular aspect of impression management. This is a significant contribution in that this shows not an increased sharing of information, but rather the creation of strategic noise. As noted earlier, the strategic release of simultaneous information with a CEO succession announcement may act as noise because it influences the market reaction itself, but more importantly because it allows firms to contest subsequent interpretations of that market reaction.

We have attempted to be exhaustive in showing robust support for our first hypothesis by ruling out alternative explanations. As mentioned earlier, although our baseline finding that CEO successions are confounded at a higher rate than expected by chance provides evidence in support of our theoretical framework, it is possible that this result is an artifact of the process by which major organizational decisions are reached. Indeed, an alternative explanation for this finding is that all major decisions from each board meeting are announced simultaneously. To help rule out this alternative explanation we compare the actual rate at which CEO successions are confounded in our sample to the actual rate at which earnings announcements were confounded in a study by Pfarrer *et al.* (2008). To the extent that all major organizational announcements are confounded at a higher rate than would be expected, earnings announcements should be confounded at a similar rate to CEO successions. Instead CEO successions are confounded at nearly twice the rate as earnings announcements. This provides face validity for a conclusion that there may be an agency explanation behind CEO successions confounded at a high rate. It appears that organizational leaders have an incentive to inject strategic noise into ambiguously negative situations, such as CEO successions, but

not in a less ambiguous context such as earnings announcements that are associated with very specific expectations.

Organizations may be more or less likely to engage in this sort of impression management in certain circumstances. Broadly, we found support for the idea that key components of the information context surrounding CEO successions influence the likelihood that firms will inject strategic noise. These findings help to reduce the likelihood that our findings are merely an administrative artifact. If the release of confounding information is simply an artifact of the process by which firms are run, it is unlikely that specific contextual factors would significantly predict the likelihood of this confounding information being released.

Specifically, we find that the longer the tenure of the outgoing CEO, the wider the gap between his or her pay and that of other top managers, and the better the stock performance of the firm, the more likely that firm leaders are to confound the announcement of the CEO succession. We interpret each element as a proxy for the perceived risk or uncertainty associated with the CEO succession. Together these specific contingencies have a substantial impact on the likelihood that a firm will intentionally inject strategic noise into its CEO succession.

If a CEO's tenure and pay are one standard deviation above the mean and the firm's market performance is also one standard deviation above the mean, the naming of a replacement is 67 percent more likely to be confounded by noise than a succession announcement without these circumstances (from 17.4% to 29.1%). Such a profile is consistent with a type of CEO who has been described as a 'celebrity CEO' (Hayward *et al.*, 2004; Wade *et al.*, 2006). While a number of studies have begun to document the impact of CEO celebrity on organizational outcomes (e.g., Graffin *et al.*, 2008; Wade *et al.*, 2006), an unexplored area is what happens when these celebrity CEOs step down. Results like ours suggest that organizations may be particularly risk averse in such situations. Future research is warranted to explore the interaction of CEO celebrity and succession events.

We also find that characteristics of the incoming, or newly appointed, CEO strongly influence the likelihood that strategic noise will be injected into a CEO succession. Specifically, we find that firm leadership is less likely to inject strategic noise when the newly appointed CEO is hired from a

high-reputation firm or when this individual has previously served as a CEO. In terms of the practical significance, these effects were much stronger than the other characteristics considered. Specifically, appointing someone who has previously served as a CEO reduces the likelihood that strategic noise will be injected by 53 percent compared to appointing someone who has never served as a CEO. Given the idiosyncratic nature of a CEO's job (Kesner and Sebora, 1994), as well as the fact that it is difficult or impossible to assess *ex ante* the characteristics that will be needed as the CEO serves his or her term (Khurana, 2002), boards of directors seem to view such prior experience as an important validating characteristic that lessens the need for information management at the time of appointment.

Another finding suggests that hiring a CEO from a high-reputation firm similarly reduces the likelihood of strategic noise by 46 percent. These findings are consistent with Podolny's (2005) observation that high status affiliations, such as working for a highly regarded firm, are particularly relevant when assessments of quality are difficult or uncertain. Thus, boards of directors seem to consider hiring a CEO affiliated with a well-regarded firm as a signal of quality that need not be obscured by strategic noise.

Our results contradict the 'big bath' explanation that the new CEO is cleaning house by releasing many negative announcement simultaneously (Greene, 1986). This procedure is known as 'big bath' accounting because the firm releases many negative announcements concurrently in an effort to clear out of all of the firm's bad news in one big splash (Greene, 1986). In fact, we found that confounding events were three times more likely to be clearly positive than clearly negative (66 versus 21).

### Practical and policy implications

Our findings have important implications for event study methodology. Event studies typically attempt to isolate the effects of a single event on a firm's stock price. Our results suggest that researchers may thereby exclude important events in CEO succession research. In other words, we might question research where the final sample's characteristics are a consequence of removing *noisy* observations. That is, confounding events may not be random, and therefore may have

systematic industry- and firm-level determinants. Consequently event study research examining ambiguously negative events such as CEO successions or mergers and acquisitions may actually compromise the internal and external validity of the findings by eliminating this 'noise.' Cook and Campbell (1979) warn that internal validity is compromised to the extent that nonequivalent control groups are created by the systemic noise induced by firms intentionally confounding CEO announcements, while Berk (1983) documents that sampling error may yield biased estimates if cases are systematically excluded.

Our findings suggest that event studies may select CEO successions in a nonrandom manner if elements of their context influence the likelihood that an announcement will be confounded in predictable ways. The external validity of a study would be compromised if the remaining firms in the sample differ systematically from the excluded firms, when the exclusion is actually the result of agency of organizational leaders. Future research could examine whether the exclusion of these confounding events has any significant effects on prior event studies.

Beyond such important methodological questions, several managerial and public policy questions are raised by the prevalence of strategic noise. In our sample, 20 percent of successions were confounded by strategic noise. As with any impression management tactic, if the practice of releasing strategic noise becomes more widely diffused, will this result in less useful information for market analysts to examine? Conversely, if the practice spreads, will the efficacy of strategic noise become muted such that the practice is no longer attractive? Moreover, while the legal and ethical considerations at this point regarding the use of strategic noise are unclear, the use itself may become a negative signal if it suggests to investors and analysts that the board is more uncertain about its choice. And while strategic noise is not the same as options backdating,<sup>11</sup> public policy makers may be interested in the fact that we show

<sup>11</sup> We are not equating option backdating with the practice of strategic noise, although both raise legal and ethical questions. Option backdating refers to the process of granting a stock option that is dated prior to the date that the company granted that option in such a way that the option is immediately in-the-money and of value to the option holder. The option backdating scandal arose in response to new information revealed as a result of an academic study by Lie: 'Unless executives possess an extraordinary ability to forecast the future marketwide movements that

(1) the practice of strategic noise exists in many CEO appointments and (2) this practice happens systematically.

### Limitations and future research

One limitation of this study is that we are not able to assess directly whether firms are releasing confounding information strategically. Rather, we infer that the process is strategic and intentional from the higher-than-chance confound rate and the significant effect of predicted contextual factors. Future research might better directly assess a board's reasoning behind the release of concurrent information. Our circumstances are similar to the work of Lie (2005) and Bebchuk, Grinstein, and Peyer (2006), in their studies of the timing of executives' option grants. They examine how likely managers are to receive stock grants at the lowest price of the month. Consistent with Lie (2005), Bebchuk *et al.*'s (2006) results indicate that about 1,150 'lucky' grants resulted from manipulation and that 12 percent of firms engaged in manipulation. In that vein, we might also try to observe directly how firms come to decide the timing and the type of information to be released about significant decisions.

Similarly, we did not examine the effects of strategic noise on the reaction of the market and subsequent firm or CEO outcomes. For instance, we theorized that the simultaneous release of important firm information in conjunction with a CEO succession announcement may help provide 'breathing room' for a new CEO. Future research could explore whether strategic noise provides any demonstrable benefit to the CEO, such as increased tenure, or a greater ability to implement proposed strategic changes. In addition, we argue that boards may release strategic noise not only because it allows them to contest interpretations surrounding negative market reactions but also because they hope that this noise may actually affect the size and direction of said reaction.

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drive these [abnormal positive] predicted returns, the results suggest that at least some of the awards are timed retroactively' (2005: 802). The practice of backdating itself was not sufficient to prove fraud (Taub and Cook, 2007); it is considered illegal by the SEC, however, and time has shown that it is sufficient to draw strong negative press, heighten legal and political scrutiny, and dampen stock prices once the practice is divulged. Prior to Lie's study (2005), however, the practice of option backdating was not publicly known, even among stock analysts, but appears to have been widely practiced.

Future research could explore the impact of confounding events on the market's reaction to CEO succession announcements.

We also could not directly observe what may be motivating organizational leadership to inject strategic noise into the CEO succession process. They might be trying to protect their own interests by obfuscating CEO succession announcements, if it is self-serving to prevent assessing shareholder reaction to the decision. Or, despite a conviction that they have hired exactly the right CEO to lead the corporation forward, they may be looking out for the best interest of the organization and guarding against information asymmetry. Indeed, shareholders without the same information or knowledge as directors might prematurely misjudge a new CEO. While each process leads to the same outcome, one is inherently self-serving and the other is not. Future researchers may try to clarify the underlying motivation for strategic noise.

An additional limitation is that we examine the role of strategic noise only within the context of CEO succession. It may be that organizations engage in anticipatory impression management only for a CEO succession because of its significance, but we might examine when and if organizations inject strategic noise into announcement of other significant events such as acquisitions, alliances, new product offerings, layoffs, changes in executive compensation, initial public offerings, or any announcement entailing uncertainty. Such research could help to flesh out the boundary conditions of the impression management technique that we explore here.

It is important to note that our theory addresses neither how the practice of strategic noise originated, nor the vehicle by which it has been disseminated among boards. In terms of origination, the earliest mention of a construct similar to strategic noise comes from autobiographies of President Dwight D. Eisenhower; Greenstein (1982: 67), for instance, referred to this practice simply as obfuscation, though Medhurst (1993: 77–78) later labeled Eisenhower's rhetoric as 'strategic ambiguity.' While boards could have observed this practice in political contexts and adapted it to their communications with the public regarding new CEOs, it is also possible that the use of strategic noise has been diffused through interlocking boards. Westphal, Seidel, and Stewart (2001), for instance, found that common board ties were

associated with the spread and adaptation of executive compensation and other corporate business practices. Management consultants might also serve as a vector for this practice. Future research could explore whether a similar relationship exists between board ties or management consultants and the use of strategic noise in CEO appointments.

## CONCLUSION

We have proposed a new direction for the study of impression management, a key theoretical lens in strategy and organizations research. Our theory suggests that firms do more than seek to manage the impressions of key stakeholders; we argue and find empirical support for the idea that they may also seek to manage stakeholder impressions through the release of confounding information. We have shown that strategic noise has been a significant factor in CEO succession, and that its occurrence is systematically affected by firm context and identifiable characteristics of both outgoing and incoming CEOs. Such results have important implications for theory as well as for event studies and new avenues for future research.

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