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LABOR MARKET EVALUATION VERSUS LEGACY CONSERVATION: WHAT FACTORS DETERMINE RETIRING CEOs' DECISIONS ABOUT LONG-TERM INVESTMENT?

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Do CEOs nearing retirement attempt to boost short-term firm performance or do they care more about what type of legacy they will leave behind? The two opposing predictions about the behavior of CEOs upon retirement suggest that retiring CEOs' decisions about certain long-term investment items may be more complex than suggested in the literature. In search of an answer to this question, we examine the relationship between CEO retirement and the level of firm commitment to corporate social responsibility (CSR). The results show that CEO retirement has a negative effect on firm commitment to CSR. However, we found that the negative effect becomes weaker when CEOs retire at relatively older ages or are retained on the board of directors of their own firms. Our finding suggests that CEOs who face weaker pressure from the labor market for corporate directors may pay more attention to preserving their legacy. Copyright © 2014 John Wiley & Sons, Ltd.

INTRODUCTION

Strategy researchers have considered CEOs as the most influential individual decision makers of firms and have studied how CEOs affect strategic decisions and firm performance (Bowman, 1986; Chatterjee and Hambrick, 2007; Hambrick and Fukutomi, 1991; Hayward, Rindova, and Pollock, 2004). To understand CEO influence on strategic decisions and firm performance, strategy scholars have used approaches based on economics and cognitive science. Economics-based approaches assume that managers are self-interest-seeking agents and focus on how incentive (mis)alignment between owners and managers affects managerial behavior (Gomez-Mejia, 1994; Sanders, 2001; Sanders and Carpenter, 1998; Wright *et al.*, 2007). In comparison, cognitive-science-based approaches focus on how cognitive frames shaped by noneconomic factors such as personal values (e.g., beliefs, ethics), personalities (e.g., hubris, optimism), and previous experience affect managerial decisions (Billett and Qian, 2008; Chatterjee and Hambrick, 2007; Doukas and Petmezas, 2007; Finkelstein and Hambrick, 1990; Malmendier and Tate, 2008).

These two approaches offer complementary theoretical perspectives for explaining the managerial behaviors of different natures or in different contexts. For example, economic perspectives help us understand why stock options may promote a CEO's long-term orientation and risk-taking (Sanders, 2001; Sanders and Carpenter, 1998; Wiseman and Gomez-Mejia, 1998) while noneconomic, cognition-based perspectives help us understand how a CEO's hubris and overconfidence may explain premiums paid for acquisitions (Hayward and Hambrick, 1997; Malmendier and

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Tate, 2008). While the two perspectives are largely complementary, sometimes they may conflict with each other in their predictions. When the two perspectives offer conflicting predictions about the behavior of CEOs in a context, it is unclear which perspective may prevail and better explain the CEO behavior in the context. In this paper, we examine this question in the context of the behavior of CEOs approaching retirement.

The behavior of CEOs approaching retirement has interested scholars of various disciplines (Cheng, 2004; Conyon and Florou, 2006; Dechow and Sloan, 1991; Gibbons and Murphy, 1992; Kalyta, 2009; Matta and Beamish, 2008; Miller and Shamsie, 2001). In particular, scholars have paid a great deal of attention to myopic behaviors of CEOs approaching retirement, which may lead to their neglect of long-term-oriented strategic investment (Cheng, 2004; Dechow and Sloan, 1991; Matta and Beamish, 2008; McClelland, Barker, and Oh, 2012). Accounting and finance scholars taking economics-based approaches have predicted that CEOs approaching retirement may reduce the level of firm commitment to long-term investment items because these CEOs are not likely to benefit from any investment with a delayed payoff (Cheng, 2004; Dechow and Sloan, 1991; Gibbons and Murphy, 1992; Murphy and Zimmerman, 1993; Smith and Watts, 1982). In response, strategy and organization scholars have proposed a complementary, cognition-based explanation of CEO behavior near retirement named the "legacy conservation" motivation (Matta and Beamish, 2008; Sonnenfeld, 1986; Zajac and Westphal, 1996). For example, Matta and Beamish (2008) found that CEOs who want to preserve their legacy of success refrain from risky acquisition decisions as they approach retirement. In explaining acquisition decisions by these CEOs, the legacy conservation explanation nicely complements economics-based approaches because the latter alone do not seem to offer a strong explanation as to why these CEOs may refrain from acquisitions. However, what if the economics-based explanation and legacy conservation motivation offered conflicting predictions about a decision of a CEO approaching retirement? When and why would one explanation prevail and predict the CEO's decision in the context more effectively?

In this paper, we study this question by observing how firm commitment to corporate social responsibility (CSR) may change as a CEO approaches retirement. Economics-based and cognitive-science-based views offer conflicting predictions on the relationship between CEO retirement and firm commitment to CSR. An economic rationale predicts that CEOs approaching retirement may try to enhance their value in the labor market by boosting the financial performance of their firms (i.e., the labor market evaluation explanation) and therefore would reduce firm commitment to CSR (Brickley, Linck, and Coles, 1999; Demers and Wang, 2010; Fama, 1980; Fama and Jensen, 1983; Fich, 2005; Harford and Schonlau, 2013; Holstrom, 1982; Rumelt, 1987). In contrast, a noneconomic rationale based on the cognition view tradition (i.e., the legacy conservation motivation [Ellis, 2006; Matta and Beamish, 2008; Sonnenfeld, 1986; Zajac and Westphal, 1996]) suggests that CEOs approaching retirement are more likely to maintain firm commitment to CSR because they would not want to destroy their personal reputations and legacies associated with CSR.

We propose two boundary conditions that may modify the relationship between CEO retirement and firm commitment to CSR. First, CEOs who retire at older ages may be less concerned about the evaluation by the labor market for corporate directors and thus may be more interested in conserving their legacy in CSR. Second, CEOs who are retained on their own boards may be under weaker evaluation pressure from the labor market and therefore care more about protecting their legacy. Our findings support our predictions and thus suggest that a retiring CEO's decision about a long-term-oriented investment may not be entirely dominated by either the labor market evaluation or legacy conservation motivation. Instead, retiring CEOs may consider both the labor market evaluation and legacy conservation and their decisions are conditional upon the relative importance they give to the labor market evaluation and legacy conservation.

This study intends to contribute to the literature on CEO decision making by proposing a more balanced and fine-tuned explanation of CEO behavior near retirement. In addition, this study speaks to other issues in strategic management. First, it addresses the subject of corporate governance and shareholder wealth protection. Understanding why retiring CEOs may make certain changes in strategic investment items can provide valuable practical implications to shareholders seeking governance mechanisms to control CEO behavior. If shareholders better understood why and when retiring CEOs reduce or increase investment in certain strategic

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investment items, they could utilize appropriate governance instruments more effectively to control CEO behavior. Second, this study contributes to the literature on antecedents of firm commitment to CSR. CSR, as a source of sustainable competitive advantage, has recently received much attention in the strategy literature (Choi and Wang, 2009; Godfrey, Merrill, and Hansen, 2009; Waddock and Graves, 1997). By comparison, antecedents of this resource have received relatively little attention. This study illustrates that CEOs and their decisions affect firm commitment to CSR.

THEORY AND HYPOTHESES

CSR as a long-term-oriented strategic investment and CEO influence on CSR

The central argument of the stakeholder theory is that firm performance and survival depend on how properly firms respond to stakeholder demands and address social issues (Clarkson, 1995; Donaldson and Preston, 1995; Freeman, 1984; Freeman and Reed, 1983). Therefore, the stakeholder theory suggests that socially responsible firms or firms that respond better to stakeholder demands will perform better than socially irresponsible firms. However, the issue of timing needs to be considered in understanding the CSR-firm performance relationship. A positive relationship between CSR and firm performance is expected to be more likely in the long term than in the short term because a positive CSR-firm performance relationship is an outcome of an improved firm-stakeholder relationship, which is a slow, time-consuming process (Brammer and Millington, 2008; Donaldson and Preston, 1995; Freeman, 1984; Godfrey, Merrill, and Hansen, 2009; Hillman and Keim, 2001; Kacperczyk, 2009; McGuire, Sundgren, and Schneeweis, 1988; Ogden and Watson, 1999). In the short run, however, firms most likely have to endure financial sacrifices when they commit resources to social issues. Spending resources on social issues such as philanthropy, diversity, environment, and human rights does not guarantee an immediate profit-generation (Deckop, Merriman, and Gupta, 2006; Mahapatra, 1984; Ogden and Watson, 1999; Short, 2004). Rather, it is more likely that commitment to CSR will have a negative impact on short-term profit by diverting limited firm resources from other more practical uses such as manufacturing and sales (Mahapatra, 1984; Ogden and Watson, 1999; Porter and Kramer, 2006; Thomas and Ely, 1996; Zadek, 2004).

While the level of firm commitment to CSR may be determined by many organizational factors, the CEO's influence on CSR is particularly notable (Agle, Mitchell, and Sonnenfeld, 1999; Coombs and Gilley, 2005; Shin, 2012; Waldman, Siegel, and Javidan, 2006; Wang and Dewhirst, 1992). Agle *et al.* (1999: 507) argue that, "Leaders, especially the CEOs of business organizations, imprint their firms with their own values, which then become manifest in decision processes that lead to stakeholder salience and corporate social performance." Waldman *et al.* (2006) also argue that CEOs are deeply involved in promoting the image of their firms by engaging in CSR. Similarly, Wang and Dewhirst (1992) argue that CEOs play a critical role in shaping their firms' CSR.

CEO retirement and firm commitment to CSR: predictions of two theoretical perspectives

Understanding the strategic importance of CSR, firms and their CEOs pay considerable attention to CSR (Waldman *et al.*, 2006; Wang and Dewhirst, 1992). Brammer and Millington (2008) estimated that large US firms spend approximately 1.75 percent of pretax profits on community and philanthropic causes alone. The total firm spending on CSR would be even larger, considering that charitable donations are one of many CSR issues in which firms engage. However, it has been suggested that as CEOs approach retirement, they may be less interested in the idea of long-term competitive advantage because they will exit the firm before they reap the returns from long-term-oriented strategic investments (Cheng, 2004; Dechow and Sloan, 1991; Hambrick and Fukutomi, 1991; McClelland *et al.*, 2012; Smith and Watts, 1982). Considering that the financial return from commitment to CSR is not immediate and requires a time-consuming process of reputation build-up and firm-stakeholder relationship improvement, CEOs who are approaching retirement may not give a strong priority to CSR.

A declining interest in CSR by CEOs approaching retirement, however, does not guarantee that they will reduce the level of firm commitment to CSR. While these CEOs may not have a strong motivation to maintain the level of firm commitment to CSR, they may not have a good reason to reduce it either. An economic rationale based on

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an agency theory perspective suggests that CEOs who are approaching retirement are not merely less interested in CSR but may have a clear incentive to minimize firm commitment to CSR. Rumelt (1987) and other scholars taking economics-based perspectives argue that the labor market for managerial talent monitors firm performance and adjusts the price of managers according to their firms' financial performance (Fama, 1980; Fama and Jensen, 1983; Holstrom, 1982). As a result, managers from firms with strong profit figures generate more high-wage offers in the managerial labor market (Fama, 1980; Ferris, Jagannathan, and Pritchard, 2003; Fich, 2005; Harford and Li, 2007; Kaplan and Reishus, 1990). Since concern about their future careers is a critical issue for managers, the labor market evaluation argument suggests that managers have a strong incentive to improve the financial performance of their firms before they exit their current firms and enter the external labor market.

CEOs who are approaching retirement are monitored and evaluated by a particular segment of the managerial labor market: the labor market for corporate directors (Coles and Hoi, 2003; Demers and Wang, 2010; Fich and Shivdasani, 2007; Gilson, 1990; Kaplan and Reishus, 1990; Keys and Li, 2005; Linck, Netter, and Yang, 2008; Masulis and Mobbs, 2011). CEOs are popular director candidates in the director labor market because of their managerial expertise, experience, and connections (Harford, 2003; Kaplan and Reishus, 1990; Mace, 1986). Also, many CEOs who are approaching retirement seek positions on corporate boards because corporate directorship provides a number of attractive rewards such as a high income, status, influence, networking, and continued participation in the workforce (Harford, 2003; Harford and Schonlau, 2013; Kaplan and Reishus, 1990; Mace, 1986). For instance, Brickley *et al.* (1999) reported that about 88 percent of retired CEOs hold at least one board seat. Vancil (1987) also reported that about 50 percent of retired CEOs hold at least one board seat. Since many retiring CEOs seek director positions on corporate boards, they pay close attention to the evaluation by the labor market for corporate directors and attempt to increase their value in the director labor market by improving the financial performance of their firms as they approach retirement (Fama, 1980; Fama and Jensen, 1983; Kaplan and Reishus, 1990; Shivdasani, 1993).

If CEOs who are approaching retirement intend to improve firm performance and their value in the director market, their efforts are expected to be most pronounced in their last couple of years before retirement. Studies on the external labor market have found that firm performance during the last years in office most critically determine a CEO's value in the labor market for corporate directors (Brickley *et al.*, 1999; Evans, Nagarajan, and Schloetzer, 2010; Kaplan and Reishus, 1990). For example, Brickley *et al.* (1999) reported that financial performance in the last two years of a CEO's tenure is 56 times stronger than firm performance in the last three to four years in predicting a CEO's directorship after retirement. Similarly, Evans *et al.* (2010) found that firm performance in the last two years of a CEO's tenure strongly predicts the CEO's directorship after retirement. Kaplan and Reishus (1990) also found that the chance of additional directorship positions is strongly predicted by firm performance the two years prior to the directorship appointment. The decisive impact of firm performance during the last years of CEOs' tenure on their prospects in the director labor market suggests that the CEOs' concern about labor market evaluation is likely to be strongest during the last couple of years before retirement.

Therefore, if CEOs who are approaching retirement intend to participate in the labor market for directors, they will attempt to boost the financial performance of their firms during their last years in office. To do so, they may focus firm resources on short-term-oriented items and minimize commitment to long-term-oriented items (Dechow and Sloan, 1991; Demers and Wang, 2010; Smith and Watts, 1982). In support of this prediction, Dechow and Sloan (1991) found that CEOs who are approaching retirement significantly reduce firm spending on R&D during their final years in office. Considering that CSR is an investment with a negative, or at best an unclear, short-term payoff (Brammer and Millington, 2008; Kacperczyk, 2009; Ogden and Watson, 1999), these CEOs have an incentive to minimize firm commitment to CSR as well. In sum, the labor market evaluation argument suggests that CEOs who are approaching retirement have a strong incentive to minimize firm commitment to CSR during their last years in office. Therefore, we predict the following:

Hypothesis 1: CEO retirement has a negative effect on firm commitment to CSR.

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While the explanation based on the labor market evaluation suggests that CEO retirement will have a negative effect on firm commitment to CSR, an alternative theoretical perspective emphasizing a nonmonetary benefit associated with CSR suggests that CEOs who are approaching retirement may not lower the level of firm commitment to CSR. CEO legacy is defined as a lasting imprint upon a firm which recognizes a past CEO (Sonnenfeld, 1986). It is suggested that when CEOs are approaching retirement, they start to think more seriously about the legacy they will leave behind (Matta and Beamish, 2008; Sonnenfeld, 1986; Zajac and Westphal, 1996). CEOs are accustomed to public attention and influence over their subordinates, which are "impossible to recreate in private life" (Sonnenfeld, 1986: 329). As a result, retirement often poses a traumatic experience and psychological cost for CEOs. In an attempt to compensate for the significant psychological cost of retirement, many CEOs want to leave a lasting legacy and continue to influence their firms and be remembered by others (Sonnenfeld, 1986). As a result, "where custom compels them to retire, CEOs may seek to preserve their legacy" (Zajac and Westphal, 1996: 68).

Among others, reputation as a socially responsible CEO is an important part of a CEO's legacy. The significance of CSR as a CEO legacy is attributable to the growing recognition of the importance of the CEO as the primary driving factor behind CSR and corporate ethical practices and culture (Agle *et al.*, 1999; Carlson and Perrewe, 1995; Manner, 2010; Posner and Schmidt, 1992; Schminke, Ambrose, and Neubaum, 2005; Shin, 2012; Trevino and Youngblood, 1990; Waldman and Siegel, 2008; Waldman *et al.*, 2006). Management scholars maintain that a firm's social responsibility is not met by some abstract organizational instruments but by individual human actors and that the CEO has the final authority and responsibility in deciding the firm's response to social and ethical issues (Thomas and Simerly, 1994; Wood, 1991). For example, Peter Drucker argues that, "CEOs set the values, the standard, and the ethics of an organization" (Lafley, 2009: 61). Agle *et al.* (1999: 507) argue that, "The CEOs of business organizations, imprint their firms with their own values, which then become manifest in decision processes that lead to stakeholder salience and corporate social performance." Similarly, Shin (2012: 308) stresses that, "the ethical orientation of the CEO is a key factor in promoting ethical behavior in an organization and creating an ethical organizational culture." CEOs themselves also seem to well understand the social expectations on them as the primary drivers of CSR and perceive CSR as a highly personal issue reflecting their philosophies and personal values (Ellis, 2006; Embley, 1993; Kochan, 2002, 2003; Orlitzky and Swanson, 2002). Considering that CSR has become a critical part of a CEO's reputation and legacy, we expect that CEOs who are approaching retirement will be reluctant to reduce the level of firm commitment to CSR and put their reputations and legacy at risk. That is, although committing firm resources to CSR may not make much economic sense to CEOs who are approaching retirement, these CEOs may not reduce firm commitment to CSR because they cherish and want to preserve their legacy in CSR. Hence, the prediction based on the legacy conservation motivation conflicts with the predicted negative relationship based on the labor market evaluation argument.

Boundary conditions modifying the explanatory power of the two theoretical predictions

If CEOs who are approaching retirement are more concerned about the labor market's evaluation than preserving their legacy in CSR, CEO retirement will have a negative effect on firm commitment to CSR. However, the negative relationship does not mean that CEOs would always prioritize a positive labor market evaluation over legacy conservation. It only implies that these CEOs "generally" appreciate a positive labor market evaluation more than preservation of their legacy in CSR. Given that both the labor market evaluation and legacy conservation arguments have some predictive value *a priori*, we expect that predictions based on these two perspectives may have more or less explanatory power under certain circumstances.

One such boundary condition is when CEOs who are approaching retirement are less interested in participating in the labor market after retirement. If these CEOs are less interested in continuing to work after retirement, they have a smaller incentive to increase their value in the director labor market. In other words, the relative importance of a positive labor market evaluation *vis-à-vis* legacy conservation becomes smaller for these CEOs. A good measure to gauge a retiree's intention to continue to participate in the workforce is his or her age at retirement (Anderson and Burkhauser, 1985; Cahill, Giandrea, and Quinn, 2006; Colsher,

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Dorfman, and Wallace, 1988; Kim and Feldman, 2000; Shultz, 2003). While many retiring CEOs may desire to serve as corporate directors, CEOs retiring at relatively older ages may be less interested in serving as corporate directors after retirement because they are more likely to have health and other issues that make continued participation in the workforce challenging (Anderson and Burkhauser, 1985; Colsher *et al.*, 1988). Old retirees' declining interest in the director labor market may be also attributable to companies' preference for younger directors (Finkelstein and Farrell, 2007; Karpinska, Henkens, and Schipper, 2013; Krings, Sczesny, and Kluge, 2011; Ray, 1996). Companies often believe that younger board members are "full of fresh ideas and eager to share their visions of a different way to run the company," while they need to "educate older board members in new technology and trends" (Ray, 1996: 12). Such bias against older directors has led to age restriction policies on directorships among many US firms, which may further discourage CEOs who are retiring at older ages from participating in the director labor market.

Findings of empirical studies on directorship also lend some support to the idea that CEOs who are retiring at older ages may be less interested in directorships. Kaplan and Reishus (1990) found that a CEO's retirement age is negatively related to the number of outside board seats a former CEO holds after retirement. Evans *et al.* (2010) found that a CEO's retirement age negatively affects his or her chances of serving on his or her own board after retirement. Similarly, Ferris *et al.* (2003) found that a director's age is negatively related to the chance of additional (secondary) directorships. The negative relationship between age and directorship documented in the empirical literature suggests that CEOs who retire at older ages may not be as successful as their younger colleagues in the director market. As a result, CEOs who are retiring at older ages may have lower expectations and less interest in the director market.

Based on the relationship between age and directorship, we propose that CEOs who are retiring at older ages may have a weaker motivation to enhance their value in the labor market for corporate directors. If they are weakly motivated to enhance their value in the labor market for corporate directors, the relative importance of legacy conservation *vis-à-vis* a positive labor market evaluation will become larger to these CEOs. As a result, they are less likely to reduce the level of firm commitment to CSR and the hypothesized negative relationship between CEO retirement and firm commitment to CSR will become weaker.

> *Hypothesis 2: The negative relationship between CEO retirement and firm commitment to CSR will become weaker if the CEO retires at an older age.*

Another boundary condition that may alter the relative importance of the labor market evaluation *vis-à-vis* legacy conservation is the retiring CEOs' retention on their own boards (Evans *et al.*, 2010; Karlsson and Neilson, 2009; Quigley and Hambrick, 2012). If retiring CEOs have already secured a director position in their own firms, they may have a weaker motivation to enhance their value in the director market. In support of this prediction, studies have shown that serving on one board (including one's own board) significantly reduces the probability of adding additional directorships (Brickley *et al.*, 1999; Ferris *et al.*, 2003; Fich and Shivdasani, 2006). There are several reasons why retention on one's own board may reduce a retiring CEO's motivation to enhance his or her value in the director market. First, retiring CEOs retained on their own boards usually serve as presidents of the boards, a highly prestigious position that guarantees large compensation, status, and active involvement in many major firm decisions (Chitayat, 1985; Dechow and Sloan, 1991; Kakabadse, Kakabadse, and Barratt, 2006; Quigley and Hambrick, 2012; Schloetzer, 2010; Vancil, 1987). The substantial benefit and privilege given to CEOs who are retained on their own boards suggest that these CEOs have a smaller incentive to seek extra director positions.

There is also a substantial burden laid on ex-CEO directors serving on their own boards. Ex-CEOs who are retained on their own boards usually have much greater responsibility than other ordinary directors. First, these retained CEOs are expected to assist the new CEO and ensure a smooth transition in leadership (Dechow and Sloan, 1991; Evans *et al.*, 2010; Schloetzer, 2010; Vancil, 1987). The most important rationale of retaining the ex-CEO on his or her own board is to minimize organizational disruption and decline in firm performance surrounding the CEO succession (Dechow and Sloan, 1991; Schloetzer, 2010; Vancil, 1987;

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Zhang and Rajagopalan, 2004). Because retained ex-CEOs have the best and most recent knowledge about the CEO position (Friel and Duboff, 2009; Schloetzer, 2010), they are supposed to provide on-the-job training and mentoring to the new CEOs, both before and after the succession (Dechow and Sloan, 1991; Schloetzer, 2010). As a result, retained ex-CEO directors are much more heavily involved in managerial decision making than ordinary directors, whose task is limited to monitoring management (Mace, 1986).

As chairmen of the board, retained CEOs also have to engage in more complex issues and take on greater responsibility than other directors. When retained on their own boards, ex-CEOs are almost always asked to serve as the chairman of the board (Dechow and Sloan, 1991; Vancil, 1987). Chitayat (1985: 65) explains that the chairman of the board has several responsibilities: "(1) to ensure that the board is properly discharging its responsibilities; it should be the chairman's task – not that of the CEO – to preside over the organization of the board and to determine what the board as a collective unit does and does not do; and (2) to relieve the CEO and his operating associates of some of the excessively heavy burden of representing the company to its external public." Furthermore, the chairman spends substantial time and effort to manage within-board dynamics and board-CEO relationships (Berenbeim, 1995; Kakabadse *et al.*, 2006; Sherman, 1991). The retained CEO's extra burden as a mentor to the new CEO and as the chairman of the board explains why "a CEO who continues to serve on his or her own board will have less time to devote to outside directorship" (Brickley *et al.*, 1999: 370). Since the burden laid on the ex-CEO directors is substantial, we expect that CEOs who are retained on their own boards may have a weaker motivation to pursue additional board seats and therefore have less concern about the evaluation of the director market.

If CEOs who have retained a seat on their own boards have a weaker motivation to enhance their value in the director market, they may worry less about improving short-term firm performance and pay relatively more attention to conserving their legacy. In other words, the CEO retention on one's own board will reduce the relative importance of a positive labor market evaluation *vis-à-vis* legacy conservation. Based on this argument, we predict that the negative relationship between CEO retirement and firm commitment to CSR will become weaker if the retiring CEO is retained on his or her own board.

Another reason CEOs who are retained on their own boards may be less likely to reduce firm commitment to CSR is because the retention aligns these CEOs' interest with their companies'.[1] If CEOs approaching retirement maintain firm commitment to CSR, it will contribute to the firms' reputations and the CEOs who are retained on their own boards may receive credit for it. Similarly, if damage to the firms' reputations is attributable to the reduction in CSR commitment during the tenure of the retired CEO who now serves on the board, shareholders and the board may find that the ex-CEO is responsible. The interest alignment effect of CEO retention has a close analogy to the concept of the repeated game (Axelrod, 1984; Camerer, 2003). If a participant is expecting the end of a game, he or she may act opportunistically to maximize the payoff, as the end is nearing. However, if the participant is expecting the game to continue, he or she may refrain from acting opportunistically and care about other parties' interests. Therefore, retention of the CEO on the board can be understood as an extension of the game between the CEO and the firm.

Hypothesis 3: The negative relationship between CEO retirement and firm commitment to CSR will become weaker if the retiring CEO is retained on his or her own board.

METHODS

Sample and data source

Our panel data are based on a combination of three different databases (COMPUSTAT Fundamental Annual, COMPUSTAT Execucomp, KLD Social Ratings). The study sample started with the 1,000 largest US firms for each year during the period of 1992–2006. There are two reasons that we focused on large US firms. First, we focused on large US firms since we assume that their resource commitment to CSR would be substantial enough to motivate the CEOs to reduce it as they

[1] We appreciate an anonymous reviewer's comment on the interest alignment effect of CEO retention on his or her own board as a complementary explanation for the moderating effect of CEO retention on his or her own board.

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approach retirement (McGuire, Dow, and Argheyd, 2003; McGuire, Sundgren, and Schneeweis, 1988; McWilliams and Siegel, 2000; Waddock and Graves, 1997). Second, we chose US firms because of the availability of CSR data. The CSR data for the sample firms were collected from the Kinder, Lydenberg, Domini (KLD) Social Ratings database, which is the most popular source of the CSR measure in academic research (Chatterji, Levine, and Toffel, 2009; Waddock, 2003; Waddock and Graves, 1997). To construct other explanatory and control variables, we collected financial data from the COMPUSTAT North America (Fundamental Annual) database and CEO-related variables from the COMPUSTAT Executive Compensation (Execucomp) database. The sample period was limited to the period of 1992–2006 because the Execucomp database provides CEO-related data only from 1992 to 2006. After we combined the three databases and removed observations with missing data in our variables, we were left with 3,536 observations for 579 firms.

There are a couple of issues that may arise in our sample construction process. First, possible sample selection bias may arise due to the limited coverage of the KLD Social Ratings database, which has the most restricted coverage among our three source databases. Heckman's sample selection bias may occur in our regressions, if *unobservable differences* that determine an observation's inclusion in the KLD Social Ratings database are related to our regressors and are left unaccounted for. However, fortunately, in our case, the criterion that determines inclusion in the KLD database is both known and observable. The official manual of the KLD Social Ratings clearly stipulates that firm size is the criterion of inclusion in the database. This means that if we control for firm size in our regression, we can remove the possible correlation between the sample selection criterion, our explanatory variables, and the dependent variable. Since we controlled for firm size in our second-stage regressions, Heckman's sample selection bias problem was solved in our case.

Our study is exposed to another related and possibly more formidable threat: the self-selection problem (Hamilton and Nickerson, 2003; Shaver, 1998). The essence of the problem is that our explanatory variable, CEO retirement, is not a random treatment variable. Such a nonrandom treatment may cause an endogeneity problem for the following reasons: (1) Our sample firms may ask/require their CEOs to retire at a certain age for some unobservable reasons. If these unobservable reasons are related to the dependent variable (i.e., firm commitment to CSR), they would cause the endogeneity problem. (This may be labeled as firm self-selection of CEO retirement timing.); and (2) Our sample CEOs may choose to retire at a certain age for some unobservable reasons. If these reasons are related to the dependent variable, they would also cause the endogeneity problem. (This may be labeled as CEO self-selection of retirement timing.) We have sought several solutions to deal with this problem. First, we controlled for a number of time-varying variables that may be commonly related to CEO retirement and firm commitment to CSR. Second, we controlled for all of the time-invariant firm characteristics that may be commonly related to CEO retirement and firm commitment to CSR. Third, we utilized an applied Heckman correction method to account for unobservable differences between CEOs who retire at a certain age and those who do not (Table 1) (Hamilton and Nickerson, 2003; Shaver, 1998). In the first-stage probit model, we estimated the probability of CEO retirement using several possible predictors of CEO retirement including CEO tenure, firm size, profitability, debt structure, and CEO compensation structure. The Inverse Mills ratios calculated

Table 1. First-stage probit model

Dependent variable	CEO retirement$_{t+1}$
Constant	−2.0270***
	(0.2868)
Firm size	0.0794***
	(0.0216)
Firm profitability	−0.0054
	(0.0041)
Financial leverage	0.1366
	(0.2302)
Free cash flow	18.6916
	(22.1184)
% profit-based compensation	0.1078
	(0.2103)
% stock-based compensation	−0.0466
	(0.1337)
CEO tenure	0.0261***
	(0.0034)
Year dummies	Included
N observations	3,536
N firms	579
Pseudo R-squared	0.0519

Robust standard errors in parentheses.
$+p < 0.10$; $***p < 0.001$.

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from the first-stage probit model served as a control for these unmeasured differences and were included in the second-stage regression.[2]

Variables

Dependent variable

Firm commitment to corporate social responsibility. The KLD ratings have been used by previous studies as a measure of firm commitment or managerial attention to CSR (Coombs and Gilley, 2005; Godfrey *et al.*, 2009; Hillman and Keim, 2001; Kacperczyk, 2009). Following the common practice in the literature (Chatterji *et al.*, 2009; Waddock and Graves, 1997), we defined firm commitment to CSR as the sum of all strength items minus the sum of all concern items.

Explanatory variables

CEO retirement. This is a dichotomous variable indicating the year of retirement and the year before the retirement year (Dechow and Sloan, 1991). We examined the relationship between the last two years of the CEO's tenure and firm commitment to CSR because a CEO's focus on short-term firm performance is expected to be most pronounced in the CEO's last two years with the firm. Previous studies have found that the evaluation pressure of the labor market for corporate director is most intense during the last two years (Brickley *et al.*, 1999; Evans *et al.*, 2010; Kaplan and Reishus, 1990). We assigned 1's to the retirement year and the year before retirement year and 0's to other years (Dechow and Sloan, 1991).

CEO age. CEO age was measured as of the current year.

CEO retention on the board. This dichotomous variable denotes whether the retired CEO served as a board member of the same firm after having stepped down from the CEO position. When retiring CEOs are retained on their own boards, they usually learn about their retention several years before their retirement because the retention is often a part of the established CEO transition routine of the firm (Vancil, 1987). Therefore, CEO retention on the board (or, more specifically, a CEO's expectation of retention on the board) can affect a CEO's decision making even before his or her retirement. Following Brickley *et al.* (1999) and Evans *et al.* (2010), a CEO was considered retained as a board member, if he/she remained with the firm two years after retirement. Examination of 10-K's and other corporate annual reports showed that sometimes the Execucomp database erroneously reported that a CEO had been remained as a director. However, the error was usually corrected after two years. Therefore, in addition to being consistent with previous studies' empirical approach, measuring CEO retention two years after retirement helps us minimize the impact of possible measurement errors.

Control variables

Following previous studies, we controlled for several variables that may influence firm commitment to CSR (McGuire *et al.*, 1988, 2003; McWilliams and Siegel, 2000; Waddock and Graves, 1997). Firm size was measured as the logarithm of the dollar value of total assets (in $ millions), and profitability was measured as return-on-asset (ROA). To control for the possibility that availability of financial resources and debt structure affect firm commitment to CSR, we included controls for free cash flow (in $ millions) and financial leverage. We also controlled for profit-based compensation and stock-based compensation of the CEOs (Deckop *et al.*, 2006) and intangible assets by including the market-to-book ratio (Dechow *et al.*, 2001). The possible influence of a senior executive position that specializes in CSR-related matters (VP of sustainability) and presence of the founder-CEO is controlled for. We also controlled for CEO equity ownership, measured as the percentage of company shares owned by the CEO. All remaining inter-temporal trends and interfirm heterogeneity were controlled for with firm fixed-effects (FE Model, Table 2) and year dummy indicators.

RESULTS

We adopted a one-year lag structure to test our hypotheses because changes in the level of firm commitment to CSR will most likely be reflected in our dependent variable in a lagged manner. We used centered variables before generating all

[2] We benefitted greatly from an anonymous reviewer's advice on the Heckman selection correction model.

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Table 2. Firm fixed- and random-effects estimation result with self-selection correction

Dependent variable Firm commitment to CSR_{t+1}	FE base $Model_{t+1}$	FE full $Model_{t+1}$	RE base $Model_{t+1}$	RE full $Model_{t+1}$
Constant	−1.6291	−1.9938	−1.4225	−1.8831
	(2.2074)	(2.2143)	(1.6498)	(1.6587)
Firm size	0.0737	0.0635	−0.0314	−0.0294
	(0.1208)	(0.1199)	(0.0614)	(0.0615)
Firm profitability	0.0169**	0.0165**	0.0168**	0.0164**
	(0.0064)	(0.0064)	(0.0059)	(0.0059)
Financial leverage	1.3944**	1.4036**	1.4223***	1.4337***
	(0.4638)	(0.4673)	(0.3035)	(0.3031)
Free cash flow	77.2376	76.0600	98.9311*	97.5599*
	(69.6474)	(69.9741)	(41.4595)	(41.4144)
Intangible assets	−0.0292	−0.0284	0.0257	0.0263
	(0.0267)	(0.0269)	(0.0285)	(0.0285)
% profit-based compensation	−0.6295*	−0.6717*	−0.6587*	−0.6936**
	(0.2975)	(0.2974)	(0.2687)	(0.2685)
% stock-based compensation	−0.6725**	−0.6925***	−0.6423***	−0.6569***
	(0.1915)	(0.1925)	(0.1789)	(0.1788)
CEO age	−0.0046	−0.0021	−0.0110	−0.0096
	(0.0109)	(0.0114)	(0.0088)	(0.0092)
CEO retention on the board	0.0522	0.0348	0.0397	0.0162
	(0.2174)	(0.2217)	(0.1437)	(0.1464)
VP of sustainability	2.7423**	2.6432**	1.7783***	1.7100***
	(0.8892)	(0.8959)	(0.4733)	(0.4733)
CEO equity ownership (% stock ownership)	−0.0082	−0.0043	−0.0074	−0.0042
	(0.0108)	(0.0094)	(0.0095)	(0.0096)
Founder CEO	−0.4974	−0.4450	0.0626	0.0758
	(1.0043)	(0.9987)	(0.2757)	(0.2761)
CEO retirement		−0.3073*		−0.2582*
		(0.1378)		(0.1305)
CEO retirement × CEO age		0.0426**		0.0423**
		(0.0145)		(0.0153)
CEO retirement × CEO retention on own board		0.3853*		0.3632*
		(0.1826)		(0.1707)
Inverse Mills ratio	1.4971	2.0118	1.5356	2.0807
	(2.3691)	(2.3814)	(1.9645)	(1.9756)
Year dummies	Included	Included	Included	Included
N observations	3,536	3,536	3,536	3,536
N firms	579	579	579	579
Adjusted R-squared	0.7282	0.7291	0.0621	0.0663

Robust standard errors in parentheses.
$+p < 0.10$; $*p < 0.05$; $**p < 0.01$; $***p < 0.001$

multiplicative terms to reduce the impact of multicollinearity on our results (Aiken and West, 1991). The descriptive statistics reported in Table 3 are values before centering.

We used both firm fixed- and random-effects estimation. In the fixed- and random-effects models (Table 2), we allowed heteroskedasticity in the error term, and calculated Huber-White robust standard errors in the estimation. We used the simultaneous regression approach rather than the hierarchical regression approach to test our interaction hypotheses because the simultaneous regression approach is more desirable than the hierarchical regression approach in minimizing omitted variable bias (Eschambadi, Campbell, and Agarwal, 2006).

The result of the fixed-effects model (FE Model, Table 2) supports Hypothesis 1, which states that CEO retirement has a negative effect on firm commitment to CSR ($\beta = -0.3073$, p-value $= 0.026$). The statistically significant and negative regression coefficient of the CEO retirement variable suggests that CEOs who are approaching retirement tend to reduce firm commitment to CSR. This result

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Table 3. Descriptive statistics and pairwise correlations (N = 3,536)

Variable	Mean	S.D.	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.
1. Firm commitment to CSR	−0.055	2.845													
2. CEO retirement	0.128	0.335	0.006												
3. CEO retention on own board	0.243	0.429	0.013	0.267*											
4. CEO age	56.63	6.669	−0.062*	0.296*	0.184*										
5. Firm size	8.453	1.486	−0.066*	0.067*	−0.053*	0.076*									
6. Firm profitability	6.003	7.359	0.129	0.000	0.021	0.051*	−0.150*								
7. Financial leverage	0.037	0.142	0.013	0.020	−0.018	0.004	0.324*	−0.151*							
8. Free cash flow	0.0001	0.0014	0.068*	0.038*	0.002	0.035*	0.155*	0.259*	−0.296*						
9. Intangible assets	1.607	1.682	0.186*	−0.004	0.046*	−0.082*	−0.229*	0.509*	−0.181*	0.172*					
10. % profit-based compensation	0.228	0.176	0.009	0.051*	0.015	0.074*	0.065*	0.165*	0.026	0.080*	−0.054*				
11. % stock-based compensation	0.492	0.283	−0.032	−0.044*	−0.088*	−0.095*	0.199*	−0.022	0.010	0.001	0.131*	−0.617*			
12. VP of sustainability	0.011	0.104	−0.016	−0.016	0.009	−0.048*	0.039*	−0.032	0.095*	−0.057*	−0.036*	−0.026	0.015		
13. CEO equity ownership	1.841	5.568	0.027	−0.006	0.074*	0.039*	−0.135*	0.056*	−0.038*	0.004	0.1096*	−0.031	−0.166*	−0.027	
14. Founder CEO	0.098	0.298	0.031	−0.045*	−0.020	0.021	−0.086*	−0.007	−0.036*	−0.002	0.122*	−0.036*	−0.022	−0.035*	0.383*

Significance level: *$p < 0.05$

suggests that CEOs may generally appreciate a positive labor market evaluation more than legacy conservation. Then, we checked the two interaction terms to examine if the explanatory power of the predictions based on the two theoretical perspectives would change. In the FE model, the coefficient of the interaction term of CEO retirement and CEO age is positive and significant ($\beta = 0.0426$, p-value = 0.003), suggesting that CEOs retiring at older ages are less likely to reduce firm commitment to CSR. This result is consistent with our prediction that CEOs who are retiring at older ages may be less interested in continuing to work after retirement and relatively pay more attention to legacy conservation. Finally, the coefficient of the interaction term of CEO retirement and CEO retention is positive and significant ($\beta = 0.3853$, p-value = 0.035), suggesting that retiring CEOs who are retained on their own boards may be less concerned about the evaluation by the labor market for corporate directors and thus are likely to maintain firm commitment to CSR to conserve their legacy in CSR. The random-effects model (RE Model, Table 2) result is largely the same.

While the one-year lagged structure of our regression may help the causal inference based on our regression results, we tried to establish a stronger case for the causality between our variables by examining the Granger causality between our variables (Berry and Sakakibara, 2008; Granger, 1969). We found that the CEO retirement Granger causes a change in firm commitment to CSR ($F = 40.27$, p-value = 0.0000), providing support for the predicted order between CEO retirement and reduction in firm commitment to CSR in Hypothesis 1. In contrast, the Granger causality test does not support the reverse direction of Granger causality (i.e., reduction in firm commitment to CSR precedes CEO retirement) ($F = 1.16$, p-value = 0.3152).

We noted that the incremental R^2 of the FE model relative to the base model is small. To check whether our explanatory variables with small incremental R^2 values added to the explanatory power of the model in a statistically significant manner, we conducted likelihood ratio tests and Wald tests (Agresti, 2002; Harrell, 2001). The result of the two tests shows that the fit of the models that additionally included explanatory variables increased in a statistically significant manner (likelihood ratio $\chi^2 = 15.29$, $p = 0.0016$; $F = 4.45$, $p = 0.0040$). The likelihood ratio tests and Wald tests showed that despite the small incremental R^2, our explanatory

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variables did improve the explanatory power of the model in a statistically meaningful manner.

Robustness check

We conducted several analyses to check the robustness of the result and rule out alternative explanations for our findings. First, when retiring CEOs receive a large amount of short-term performance-based compensation (e.g., bonuses), they may reduce investment in long-term items such as CSR in order to maximize their compensation at departure (Smith and Watts, 1982). If this alternative explanation explains the negative relationship between CEO retirement and firm commitment to CSR, when short-term performance-based compensation makes up a large proportion of the total compensation of retiring CEOs, the negative relationship between CEO retirement and firm commitment to CSR may become stronger. In addition, when long-term performance-based compensation (e.g., stock options and restricted stock grants) makes up a large proportion of the total compensation of retiring CEOs, the negative relationship between CEO retirement and firm commitment to CSR may become weaker. To examine this possibility, we included interaction terms of CEO retirement, bonuses, and stock-based compensation (i.e., stock options and restricted stock grants). The results show that none of the interaction terms are statistically significant.

We also examined the possibility that the negative relationship between CEO retirement and firm commitment to CSR is attributable to firms' inability to pay enough attention to CSR-related issues during the periods of CEO turnover. To examine this possibility, we ran regression models on a sample where CEO departures were the result of resignation or death, which should pose more challenging transition issues than CEO retirement. However, no significant relationships between CEO departure and firm commitment to CSR were observed in this sample.

Another concern is that CEOs who retire at young ages may be interested in other CEO positions rather than director positions or may not be interested in continuing to work after retirement at all. To address this issue, we conducted a set of sensitivity tests by removing from our sample the CEOs who retired relatively early because these CEOs may not be interested in continuing to work after retirement or may seek career options other than directorships. In addition, we removed the observations of CEOs who are also founders of the company. The founder-CEOs may have substantial wealth and thus may not have an incentive to participate in the director labor market. When we removed observations of (1) the CEOs who retired relatively early and may have had different career plans and (2) the founder-CEO observations, all our hypotheses remained supported.

Finally, if factors other than financial performance determine retiring CEOs' value in the labor market, our prediction and empirical findings may be compromised. For example, if CSR is an important evaluation criterion used by the labor market, CEOs who are approaching retirement would not cut firm commitment to CSR. To examine this possibility, we regressed (1) retention on their own boards and (2) the number of total board seats held on firm commitment to CSR. We found that firm commitment to CSR predicts neither the retention on one's own board nor the number of total board seats of a CEO.

DISCUSSION AND CONCLUSION

Retiring CEOs' decisions about strategic investments are important for shareholders because such decisions critically influence the long-term competitive advantage of a firm (Barker and Mueller, 2002; Conyon and Florou, 2006; Dechow and Sloan, 1991; Smith and Watts, 1982). Unfortunately, predictions and findings concerning retiring CEOs' decisions about investment items have been somewhat ambiguous (Conyon and Florou, 2006; Murphy and Zimmerman, 1993). CEOs' mixed motivations behind their investment decisions are at least partially responsible for such ambiguity. Some CEOs may be more concerned about the labor market evaluation and focus on short-term firm performance as they approach retirement, while other CEOs may be more concerned about preserving their legacy. Given that both the labor market evaluation and legacy conservation motivation arguments provide viable *a priori* explanations of CEO motivation, the critical question is when and why CEOs may shift their priorities between these two conflicting goals.

In this study, to understand when and why CEOs may change their priorities between a positive labor market evaluation and legacy conservation, we examined the relationship between CEO retirement

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and firm commitment to CSR. The findings of this study suggest that retiring CEOs may generally give priority to short-term performance. However, when retiring CEOs are less concerned about the labor market evaluation, they may pay more attention to building and preserving their legacy. The findings of this study suggest that retiring CEOs' priority on legacy conservation is closely determined by their personal expectations of bridge employment (i.e., employment after retirement) (Kim and Feldman, 2000). When CEOs are less interested in bridge employment for some reasons such as old age, or they have already secured a job such as retention on their own boards, they have a weaker incentive to improve their value in the labor market. Instead, these CEOs may pay more attention to preserving their legacy.

Findings of this study speak to the need to give more authority to an independent CSR function or to personnel in charge of CSR. The fact that decision making about CSR is greatly influenced by CEOs in many firms (Ellis, 2006; Embley, 1993; Kochan, 2002; Orlitzky, Schmidt, and Rynes, 2003) implies that the CSR programs of those firms are vulnerable to inconsistencies and changes during times of CEO change. If building a reputation in CSR requires consistency over time, leaving CSR decisions primarily to CEOs would not be ideal. One of our control variables, VP of sustainability, is positively related to firm commitment to CSR in a highly significant manner. This significant positive effect of VP of sustainability on firm commitment to CSR suggests that these executives do make a difference in CSR. However, the presence of these executives still does not prevent a negative relationship between CEO retirement and firm commitment to CSR. This result also suggests that the power given to these CSR-executives may not be substantial enough.

In our robustness check section, we examined if firm commitment to CSR could predict retiring CEOs' future board positions. Although we did not find evidence of firm commitment to CSR as a statistically significant predictor of retiring CEOs' board positions, this additional analysis gives rise to an interesting future research question. Would the director/managerial labor market consider CSR when evaluating managerial ability? If so, when would CSR be a more or less relevant factor? The statistically insignificant coefficient of firm commitment to CSR suggests that ethical and socially responsible CEOs may not be appreciated or sought after in the labor market. However, this finding does not rule out the possibility that firms avoid CEOs with serious ethical problems as their directors. That is, it is possible that CSR may be used as a sanitary check in the director labor market. To further explore this possibility, we examined the relationship between a CEO's directorship and exceptionally poor CSP. In this further analysis, we found that even a CEO's exceptionally poor CSP does not predict the CEO's directorship in a statistically significant manner.

Other possible future research questions include whether firms may apply a more or less stringent CSR standard to a director candidate, depending on the ownership structure of the firm. For example, family-owned companies and publicly-owned companies may have different standards. As another example, companies included in the socially responsible investor (SRI) fund may apply a different standard than other institutional owners. Another interesting question is related to characteristics of the firms constituting our sample. As we described in our data section, we focused on large US firms to test our theoretical predictions. Since we controlled for our sampling criterion (i.e., firm size) in our regressions, our focus on large US firms should not bias our estimation result. However, it is possible that our regression result may not hold for a sample consisting mainly of small and foreign firms. If future researchers can obtain comparable data on small firms and foreign firms, it would be both theoretically and empirically meaningful to examine if the current findings can be replicated among them. While we do not investigate these questions in this paper, we believe that these are interesting and worthy questions that deserve scholarly attention.

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