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Founder Involvement in CEO Turnover

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Abstract

We study the role of a company founder in its internal governance. Using a sample of 484 CEO turnovers for 2000–2015, we establish that CEOs are fired for poor performance. However, the likelihood of a poor-performing founder-CEO being fired is lower than that of an outsider CEO. Moreover, having a founder as a member of the executive or supervisory board decreases the likelihood that a CEO will be dismissed for poor performance. Similarly, founder ownership may have the same effect on CEO turnover. Finally, being a founder does not guarantee a poor-performing CEO a chairman position after being fired.

Keywords: Founder involvement; CEO turnover; Corporate governance; Firm performance

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1. Introduction

Founders are passionate about the companies they have created based on their vision. Their passion motivates them to maintain a central role within the firm and control its long-term development, particularly by acting as the CEO. Empirical studies, however, find a mixed impact of founder-CEOs on operating performance and market valuation. [Morck et al. \(1988\)](#) find a negative effect of founding family control on market valuation, but only for older firms. One explanation is that new ventures may extend beyond the managerial capabilities of their founders even when the founder is reluctant to relinquish management. Founders often have an emotional attachment to their company and are willing to forego economic benefits for personal satisfaction. Despite this, [Fahlenbrach \(2009\)](#) finds that firms led by founder-CEOs outperform those led by non-founder-CEOs in both stock performance and market valuation. The contradictory results might reflect the inherent tension between the profit and control motives in companies managed by a founder-CEO. Thus, founders are concerned with financial performance, but also with their socioemotional wealth through those firms ([Berrone et al., 2012](#)). Following the family firm literature, we define socioemotional wealth as the non-financial aspects of the firm that meet the founder's affective needs such as identity or the ability to realize the firm's vision. Hence, whether to fire a CEO, particularly when the CEO is the founder or strongly related to the founder, after bad performance is a critical but important decision made by the company board. We shed some light on such decisions by investigating CEO turnover controlling for the different roles of founders within firms. The analysis of a CEO dismissal decision is one way to assess the quality of

internal corporate governance within a company or country. The sensitivity of CEO turnover to poor stock performance or financial results is considered a strong signal of an effective internal corporate governance system. Empirical studies provide evidence confirming a negative association between CEO turnover and stock market or firm performance across countries. [Warner et al. \(1988\)](#), using US data, find an inverse relation between the probability of management change and a firm's share performance. In addition, [Weisbach \(1988\)](#) documents that there is a stronger association between stock returns or earning changes and the probability of a CEO dismissal for companies with outsider-dominated boards than for companies with insider-dominated boards. Hence, the study confirms the importance of governance standards for the dismissal decision. A large number of studies confirm this relationship using different country settings, for example, [Franks et al. \(2001\)](#) for the United Kingdom, [Volpin \(2002\)](#), [Brunello et al. \(2003\)](#) for Italy, [Lausten \(2002\)](#) for Denmark, [Suchard et al. \(2001\)](#) for Australia, or [Kang and Shivdasani \(1995\)](#) for Japan.

Most studies concentrate on developed countries with a relatively high level of corporate governance standards, while the literature on corporate governance systems in less developed markets is sparse. In our study, we explore the relation between forced CEO turnover and firm performance in a country with low-quality institutions and governance standards. We focus on how CEO turnover is affected by founders, including the situations where a founder is the current CEO or only a board member. After a period of rapid company growth, founders have often decided to assume a passive role in their firms by taking a position as a member of the executive or super-

visory board. However, they still may shape the development of a firm by influencing CEO replacement decisions. If founders who are board members are effective monitors relative to dispersed shareholders, we would expect a stronger relation between firm performance and the probability of forced CEO turnover. Meanwhile, whether an external CEO succeeds a founder where the latter still plays a significant role is probably strongly determined by the founder's opinion. Moreover, the current CEO is likely to execute the founder's strategy in situations where the latter maintains a monitoring role in the firm. Therefore, the likelihood that the current CEO will be fired is less when the founder is monitoring the company as a member of the management or supervisory board. We use a unique hand-collected sample of 359 companies listed on the Warsaw Stock Exchanges (WSE) from the year 2000 to the year 2015 to test the aforementioned assumptions.

Our paper contributes to the literature on CEO turnover by focusing on founder-CEO replacement. The existing evidence related to management turnover and performance in developing or emerging countries, characterized by low levels of corporate governance, is sparse. [Campbell II and Keys \(2002\)](#) examine the effectiveness of corporate governance in South Korea and report a negative relation between CEO turnover and firm performance. [Campbell II and Keys \(2002\)](#) also show that top executive turnover is completely unrelated to performance for leading chaebol firms. Based on the results, they conclude that internal corporate governance is much weaker in chaebols, consistent with anecdotal evidence that chaebol firms are interested in goals other than profit maximization. Our results complement their findings. However, the results are in contrast to [Jenter and Kanaan \(2015\)](#) and [Adams](#)

[et al. \(2009\)](#), who do not find that founder-CEOs are immune to dismissals as a result of poor performance.

Second, we provide additional evidence on a controversial issue related to the turnover-performance relation, which is the impact of CEO shareholdings on internal monitoring efforts. Some argue that when the CEO is an equity holder in the company, the CEO can potentially become entrenched, and the officer's shareholdings may prove a stumbling block to those who wish to hasten the CEO's departure because of poor performance ([Morck et al., 1988](#)). The existing evidence related to the role of equity in the turnover-performance relation is both sparse and mixed. We find contradictory results for outsider CEOs and founder-CEOs, and attribute these findings to differences in values: a founder-CEO may try to protect the company even at the cost of personal benefits.

Third, we explore the role of founders as monitors and their impact on CEO turnover. [Morck et al. \(1988\)](#) provide some evidence of entrenchment of founder-executives. In a sample of Fortune 500 firms, the authors find that firms whose top management teams contain members of the founding family are less likely to experience a complete turnover of top executives and to be targets of hostile takeovers. [Lausten \(2002\)](#) analyzes the role of the chairman of the board in the monitoring of top executives and its impact on CEO turnover. [Lausten \(2002\)](#) finds that the probability of CEO turnover increases if the chairman of the board is an insider with respect to firm ownership. Similarly, [Bresser and Thiele \(2008\)](#) show that a firm's current CEO is more likely to be dismissed following poor performance when a former CEO is the chairman the supervisory board. We present new evidence on

these aspects.

Finally, we analyze the transition of former CEOs to the supervisory board. [Andres et al. \(2014\)](#) report that the announcement of a transition of a retiring CEO to the supervisory board is considered good news by the shareholders. The authors find that executive compensation and compensation of the supervisory board members increases after CEO transition to the supervisory board. However, they do not find any negative effect of CEO transition on the long-run share or operating performance. In contrast, [Bermig and Frick \(2010\)](#) find evidence of a negative relation between the percentage of former managing board members on the supervisory board and the firm's market value. Consequently, the literature shows ambiguous results concerning the effect of CEO transition to the supervisory board. No existing studies, however, analyze what determines the transmission of a former CEO to the supervisory board. We shed some light on this by investigating the determinants of CEO turnover and the CEO's transition to the supervisory board. We analyze the determinants only, but with a focus on the role of firms' founders in the transmission of former CEOs to the supervisory board. The remainder of this paper is organized as follows. Section 2 presents the institutional background to our study. Section 3 outlines our sample and describes the data and research design. Section 4 presents our empirical findings and evaluates our results, and Section 5 concludes the paper.

2. Institutional background

The WSE re-opened in 1991 and developed gradually, first through privatization and later through the IPO of private companies. In Poland, listed

domestic-owned private firms are mostly first generation, where the founder also still serves as the CEO. These companies were mostly established after 1989 and are considered relatively young compared with their counterparts in industrial countries. The first privately founded firm, Efekt, went public in 1993. The IPO of this company was successful, and while in 1994, only two out of 22 public offerings were private companies, almost all IPOs were related to already privately-owned firms in 1999 (Kowalewski et al., 2008). Some of the founders decided to exit and sell their controlling shares after the IPO while others used the raised capital for further expansion. However, not all of the listed domestic-owned firms are successful in the long term. For instance, in 2018, a debt collector, GetBack, that was founded in 2012 and went public in 2017, filed for court-brokered bankruptcy protection and restructuring. The company was controlled by private equity funds and had many foreign investors, yet it failed to redeem its bonds only one year after going public. The founder-CEO was dismissed only a few days before the company defaulted, which was a surprise, as only a few weeks earlier, the firm was recognized as the fastest growing company on the WSE. The failure of this company revealed that the governance structure was weak and had allowed the founder-CEO to alter financial statements to hide financial losses. At Simultaneously, there was increased leverage from public and private bond issues. The IPO prospectus and the financial statements were audited by one of the big companies, but the discrepancies were not discovered until it was too late.

The internal governance structure of Polish joint stock companies is composed of two elements: a general meeting and a supervisory board. The

board system is two-tier, which means that all members are non-executives and that CEO duality is prohibited. The management board is responsible for business conduct, and the board's decisions are restrained only by the supervisory board. The supervisory board is independent, monitors managers' performance, and has the power to appoint or dismiss managers at any time. There is no legal requirement for education or expertise of supervisory board members. The members of the supervisory board are elected at the general meeting, which means major shareholders can vote for members who meet the criteria of independence and yet follow their interests. As a result, internal governance standards are relatively weaker than those of developed countries ([Kowalewski, 2016](#)). The chairman of the GetBack supervisory board, who was recommended by private equity funds, publicly declared that he was unaware of the firm's difficulties prior to its default.

External governance mechanisms are also weak because of limited contestability to hostile takeovers due to underdeveloped institutional frameworks and the absence of institutional investor activism. According to [Bonin and Wachtel \(2003\)](#), stock markets in Central Europe leaped into existence before the institutional infrastructure was established. Resultantly, the share listings often did not guarantee transparent share registration, the ability to transfer ownership, or the absence of price manipulation.

These facts support the notion that the legal system and external and internal governance mechanisms are not strong enough to control managerial discretion, particularly for firms' founders. Hence, a founder can create a mechanism whereby firing them is costly. However, CEO turnover is an important ingredient of corporate governance and, for that reason, the WSE

is an appropriate place to test corporate governance functioning taking into account the strong position of founder-CEOs and Poland’s weak institutions.

3. Empirical approach

This section describes our data and outlines the main estimation technique.

3.1. Data

Our data set covers companies listed on the WSE during 2000–2015. We focus only on forced CEO turnover as these dismissals represent governance actions. We hand-collected dates of CEO turnover announcements and the stated reasons for departure by analyzing company statements and news articles. All CEO turnovers for which the official statement or a press release reports that the CEO was fired, forced out, or resigned due to pressure are classified as forced. This analysis is necessary since CEOs are rarely openly fired. We decided to exclude the cases where we were not able to classify the reason for CEO turnover, particularly for CEOs over the age of 65. In our sample, a forced CEO change occurred in 484 year-observations, a frequency of approximately 15%. Table 1 shows the descriptive statistics with variable definition.

Table 1

To investigate the role of founders, we collected information on who established the companies and whether the founders maintain an active role in firm governance. We encoded the information on founders using multiple dummy variables. The dummy variables *F-CEO* and *F-MGT* take the value one if

the founder is the CEO or only a member of the management board, respectively, and zero otherwise. As companies develop, founders often decide to move from a top management member to a supervisory board member. This allows them to continue to influence company development but to be less involved in day-to-day operational decisions. The dummy variables *F-Chair* and *F-NED* take the value of one if a founder is the chairman or a member of the supervisory board, respectively, and zero otherwise. Moreover, a founder can also be forced to resign or fired. Consequently, we supplement the information on CEO turnover by encoding the cases where a founder is dismissed (*F-CEO Turnover*).

We supplement the governance data with information on insider ownership, which was retrieved from Reuters. We eliminated firms that are state-controlled; the number of forced CEOs in our sample declined to 426 year-observations. In state-controlled companies, a decision to dismiss a CEO is more likely to be determined by political rather than economic motives. The regression results confirm our assumptions, and the coefficient of the dummy for state ownership was positively and statistically related to CEO turnover. We do not show the results for brevity, although they are available upon request.

In the following regressions, we control for firms' founder ownership (*F-S'holder*) using a dummy variable that takes the value of one if the founder holds shares in the company and zero otherwise. As already reported, many of the companies listed on the WSE are relatively young, and we report founder ownership in 900 year-observations, which represents over 28% of our sample. Some argue that when the CEO is an important equity holder

in the company, the officer can become potentially entrenched and his/her shareholdings may prove a stumbling block to those who wish to hasten the CEO's departure after poor performance (Morck et al., 1988). Hence, we additionally control for CEO ownership using a dummy variable *CEO S'holder* that takes the value one if a CEO holds shares in the firm and zero otherwise. Interestingly, we find a strong overlap between founders and CEO shareholders. In almost 90% of the year-observations when a founder is a shareholder, the founder is also the CEO. This relationship confirms that a significant share of the firms in our sample are first generation firms that have been taken public by the founder-CEO.

We obtain financial data for the companies by extracting balance sheet information and financial ratios from Reuters. We follow the literature and employ both accounting-based and market-based performance variables. For an accounting-based measure, we use return on assets (*ROA*), which is calculated as net income over total assets. We focus on net income rather than EBIT as our sample includes companies from the financial sector. *ROA* is a better measure to compare companies across industries, and it is not distorted by industry characteristics. As a second measure, we use stock return (*Return*), which is adjusted for dividends and splits. The implications of the performance variables are radically different in each case. *ROA* reflects a tangible, balance-sheet effect on companies' performance while the market return is concerned more with the market perceptions of future earnings and the value of the company. Kaplan (1994) suggests that stock returns also reflect changes in discount rates and accounting earnings may be more informative. The empirical evidence is ambiguous on this issue and, to en-

sure the robustness of our results, we use two measures for firm performance. Some correlation is expected between the two performance measures, but this might not always be the case.

With reference to the firm’s characteristics, we include three control variables: market value to book value (*Market to Book*), total debt to assets (*Leverage*), and natural log of total assets (*Size*). Leverage is taken as we assume that leverage may affect CEO turnover. The debt ratio can improve performance by limiting managerial misbehavior, particularly as bank financing is important in Poland and institutions providing debt financing may play an active monitoring role. [Ofek \(1993\)](#) finds that the probability of top management turnover following a large stock price decline is inversely related to the ratio of public to total debt. [Marshall et al. \(2014\)](#) document that bank monitoring can play a crucial role in managerial discipline and find a stronger relation between forced CEO turnover and cash flow performance. In the regression, we control for industries using dummies. We distinguish between the different industries based on the WSE industry group definitions. Appendix Table 1A shows the distribution of the sample across industries; the final sample includes 380 public companies with 3,507 observations for each variable for 2000–2015.

3.2. CEO Turnover and Founders

We follow [Volpin \(2002\)](#) and employ a probit regression to examine the sensitivity of CEO turnover to firm performance. In the regression, we use dummy variables that control for the founder’s position within the firm in terms of both additive effects and interactive effects on the performance measure. As

a result, our main regression takes the following form:

$$PR(CEO) = \alpha + \beta_1 P_{i,t} + \beta_2 F_{i,t} + \beta_3 C_{i,t} + \gamma_t + \delta_i \quad (1)$$

where CEO is equal to 1 if the firm experiences a forced CEO turnover in firm i and year t , P refers to one of our performance measures, F is a vector representing founders and governance characteristics of the company, and C is a vector representing firm control. γ represents year fixed effects that capture time-varying macroeconomic trends while δ represents industry fixed effects that control for industry characteristics. All specifications are estimated with robust standard errors clustered at the firm level. Tables 2 to 3 present both the coefficients and marginal effect while Tables 4 to 8 show only the marginal effects to save space and simplify the economic interpretation. The reported marginal effects represent the change in probability of an infinitesimal change in each independent variable evaluated at the average values of the regressors. We cannot control for firm effects in a probit model. Therefore, we re-estimated all our regressions using a linear OLS model with fixed effects at the firm level and robust standard errors. We find that the results of the OLS regressions are in line with the results reported in the study. We do not report the results of the OLS regression for brevity; however, they are available upon request.

4. Results

4.1. CEO turnover and firm performance

Table 2 shows how firm performance affects CEO turnover decisions. From the perspective of effective monitoring, there should be a greater likelihood

that a CEO will be replaced after poor performance. In column (1), the performance measure ROA is contemporary while, in column (2), it is lagged by one period. The results reveal that company performance measured by ROA has a significant effect on the CEO dismissal decision. In columns (1) and (2), the coefficient for ROA is negative and statistically significant at the 1% and 10% levels. In terms of economic significance, when ROA decreases by one standard deviation, the probability of CEO turnover in the current year increases by 4.7% while, one year later, the probability of turnover increases only by 1.5%.

In columns (3) and (4), we repeat the regressions and employ market return as the performance measure. We find that CEO turnover does not always decrease with performance when it is proxied by the stock market return. Specifically, in column (3), we find that the coefficient is negative and statistically significant at the 5% level. In economic terms, this implies that the probability of CEO turnover in the current year increases by more than 2% if the market return decreases by one standard deviation. However, in the last columns, we find that the coefficient for market performance is positive and insignificant. The results are in line with [Volpin \(2002\)](#) who also did not find significant results when the performance was proxied for stock return.

In line with our expectation, we find that the coefficient of the leverage variable is positively related to CEO turnover, yet it is significant only in three of the four specifications. On the one hand, this may indicate a weak debtor monitoring mechanism. On the other hand, [Marshall et al. \(2014\)](#) argue that the strength of bank monitoring of poorly performing managers is conditional on firms' raising of bank debt. The authors find that CEO succession deci-

sions are unrelated to existing banking relationships, which may explain our relatively weak results. We also find a weak relationship between the ratio of the market to book value of the firm and CEO turnover although this can be explained by the fact that stock value is not the best measure in a shallow market. As the control variables are consistent in all the following specifications, they are not discussed further.

Overall, the results confirm that CEO turnover is negatively related to performance. However, the relationship is significantly weaker when stock return is used as the performance measure. The results are not surprising as [Warner et al. \(1988\)](#) document that only extreme levels of stock price performance affect the likelihood of top management change. [Volpin \(2002\)](#) argues, on the other hand, that stock return is not the best measure of performance in a sample of Italian firms where stock suffers from a lack of liquidity and infrequent trades. The same argument could be applied to our sample as the WSE is still a developing and shallow equity market.

Similarly, the stronger effect of contemporaneous financial results on CEO turnover can be explained by the governance of companies in our sample. In Poland, all domestic companies have a two-tier board system whereby a supervisory board represents all the shareholders who have elected the board to promote their interests. The supervisory board's main obligation toward the shareholders is to supervise the executive directors, and the board has the right to replace the executive directors including the CEO at any time. Moreover, the companies in our sample are listed and are obliged to disclose their financial results quarterly. Hence, a decline in a company's financial performance will put pressure on the supervisory board to undertake action

including a change in CEO. In case a supervisory board does not undertake any change, it runs the risk that its members may be revoked at an extraordinary shareholders general meeting called by one of the block shareholders or at the annual shareholders meeting. Consequently, we assume there is strong pressure on the supervisory board. In further analysis, we used only the current financial results of the companies in the following regressions. As a robustness check, we also used the lagged variables. Using lagged values, we find that the coefficients do not change the signs, but the results are statistically weaker. We do not show those results for brevity; however, they are available upon request.

Table 2

Table 3 whether CEO turnover sensitivities differ if the CEO is also the founder of the company that they manage. We repeated our previous estimation although this time the dependent variable represents the forced turnover of the founder-CEO. In all the specifications, the performance variables are negative yet statistically significant only when we use market returns as the performance measure. Consequently, the results contrast with our previous results as founder-CEO turnover is only sensitive to market return. Moreover, we find that the marginal effects in Table 3 are significantly smaller than in 2. This implies that the likelihood that a founder-CEO will be fired is less likely than an outsider will be fired even when the company underperforms. Our results are in contrast to [Jenter and Kanaan \(2015\)](#), who examine whether CEO-founders are affected differently by peer group performance than other CEOs. The authors find no consistent effects of CEO power on a firm's propensity to use relative evaluation in their CEO turnover

decisions. We argue that our results confirm that firm founders hold a special position within a company, which justifies our further investigation.

Table 3

4.2. CEO turnover and ownership

According to entrenchment theory, managers that hold little equity capital in a firm may deploy corporate actions to obtain personal benefits if the shareholders are too dispersed to take action against non-value maximization behavior. [Shleifer and Vishny \(1989\)](#) develop a model of managerial entrenchment whereby managers may make specific investments that increase their value to shareholders. Those investments, however, might be aimed at reducing the likelihood of being replaced and, consequently, may only have entrenchment value. [Weisbach \(1988\)](#) shows that insider ownership is strongly correlated with the composition of the board, whereas CEOs have an incentive to avoid including outsiders on the board. Following [Jensen and Meckling \(1976\)](#), [Weisbach \(1988\)](#) argues that as a CEO's shareholding grows as a fraction of his wealth, the interests of the CEO are more aligned with those of the shareholders. As a result, if the CEO has a large equity stake in the firm, there may be less need for monitoring by outside directors. [Weisbach \(1988\)](#) main finding is that outsider-dominated boards are more likely to fire a CEO following poor performance than insider-dominated boards. Hence, the author argues that outside dominated boards tend to increase shareholder value through their CEO changes. Moreover, [Weisbach \(1988\)](#) finds that the increased shareholding of a CEO reduces the probability that the CEO will resign, yet the results were statistically insignificant. Nevertheless, we assume that insider shareholding may prove an obstacle to those who wish to

hasten the departure of the CEO for poor performance.

We test the entrenchment theory by controlling for ownership of the company by a CEO using a dummy variable. Columns (1) and (3) in Table 4 show the results for all the forced CEO turnovers while columns (2) and (4) show the results for the founder-CEOs. We find that adding the additional control variable does not change our main results. We find that CEO turnover, including the dismissal of the founder-CEO, is strongly related to firm performance. The marginal effects are, however, significantly smaller for the founder-CEO than for the outsider CEO. Moreover, in column (2), the coefficient for performance measured by ROA is statistically insignificant.

Interestingly, we find significant differences in the impact of outsider CEO and founder-CEO ownership on their dismissals. In columns (1) and (3) of Table 4, the coefficients of variable CEO ownership are negative and statistically significant at the 1% level. This implies that a CEO dismissal is less likely if the outsider CEO is a shareholder, which is in line with entrenchment theory. The interaction term between the performance variable and CEO ownership in columns (1) and (3) shows that the likelihood that a CEO will be dismissed following a bad performance increases if the CEO does not own shares. Hence, the results show that the likelihood that an outsider CEO will be fired following bad performance declines if the outsider CEO is also a shareholder of the firm. We attribute this situation to the relatively low governance standards and the lack of shareholder activism in Poland.

In contrast, in columns (2) and (4) of Table 4, we find that the coefficients of the variable founder-CEO ownership are positive but statistically significant

only in the first specification at the 5% level. This implies that founders who are shareholders are more likely to support their own dismissal as CEO. We may assume that founders have a personal attachment to the company they build, which may explain their different behavior compared to outsider CEOs. The results support the arguments of [Jensen and Meckling \(1976\)](#) who argue that the interests of the CEO may align with those of the shareholders, whereas we attribute the different behavior more to personal motives. The interaction term between performance and founder-CEO ownership supports our arguments. In columns (2) and (4) of Table 4, the coefficient of the interaction term is negative and statistically significant in the first specification at the 10% level. We assume that founder-CEO faces pressure when the company underperforms and, at some point, decides to step down even when they are shareholders. We also assume that a significant fraction of founders' wealth is attached to the company, which could also explain their decision to resign as CEO. We are, however, unable to establish what ultimately drives the founder's decision to resign as CEO, and we leave this for further research. Our results do show that insider ownership is related to the dismissal of outsider CEOs and founder-CEOs in different ways.

Table 4

4.3. CEO turnover and founders as monitors

Having established these baseline results, we expand our analysis by controlling for different functions of a founder within the company. We do this by regressing the dependent variable against our performance measures and progressively employing dummy variables that control for the different positions held by a founder within a company. Additionally, in the regressions,

we use a dummy variable that controls for insider ownership.

First, this analysis allows us to verify our previous results on CEO turnover. Second, the analysis allows us to explore situations where the founder is a member of the executive board. We may assume that, in most cases, the founders voluntarily stepped down as CEO and took a passive role on the board. Doing so gives the founder the advantage of less responsibility while, at the same time, retaining the ability to advise and directly monitor the current CEO. Third, and most importantly, the assumption that the founders voluntarily stepped down as CEOs and took a passive role on the board allows us to investigate the role of founder in the supervisory board where their main responsibility is to monitor the top executive board members. On the one hand, founders have firm and industry expertise that should allow them to effectively monitor the executive board members. On the other hand, it is likely that the founder monitors a CEO that the founder chose as their successor and who only follows the founder's previously outlined strategy for the firm. Consequently, a founder who assumes a passive role may impede necessary changes in the firm, particularly in the context of a CEO turnover following poor firm performance.

The results in Table 5 are in line with our previous finding and confirm that a company's performance measured by ROA strongly affects the dismissal decision of the CEO. Controlling for insider ownership and adding the different control variables for the position of the founder within the company hardly changes the coefficient of the performance measure ROA, which remains negative and statistically significant at the 1% level for all the specifications. Again, we find that insider ownership is negatively related to CEO turnover.

The coefficient of the variable proxying for insider ownership is significant in all specifications at least at the 1% level. In columns (1) and (2), we introduce a variable that controls for founder position as CEO and executive board member, respectively. We find that the coefficients of both dummy variables are negative and statistically significant at the 1% level. Consequently, we find that founder presence on the executive board influences the CEO dismissal decision. We find that if the founder is a CEO or executive board member, the likelihood that the CEO will be fired declines by 10% and 7%, respectively. The first result is in line with our previous finding and confirms that being a founder reduces the likelihood of being fired after bad performance by the firm. While these results are probably related to the fact that a founder who is a member of the executive board has an impact on the election of a dismissed CEO. Our results supplement those of [Evans III et al. \(2010\)](#), who find that former CEOs on the board are likely to have significantly more bargaining power than an exiting CEO as the former CEO is more likely to have been board chairman and/or the firm's founder. Moreover, the authors document that boards with former CEOs are more likely to select a new CEO who is a younger insider without prior CEO experience and may have family ties to the former CEO. As a result, the authors argue, the former CEO is likely to exert significant influence over the successor. We argue that a founder on the board is likely to protect a poor-performing CEO as the founder probably selected the CEO and influences his decisions. The interaction terms between the performance measure and the variables for the founder's position with the executive board align with our assumption. We find that a CEO outsider is likely to be fired, even when the founder is an

executive board member, when a company under-performs. Conversely, the situation does not hold if the CEO is the founder, which is in line with the results in 3. In other words, the results confirm that dismissing a founder-CEO can be much more difficult than dismissing an outsider even when the company performs poorly. In columns (3) and (4), we employ a dummy that controls for founder position as chairman and member of the supervisory board. We find that the coefficients of both control variables are statistical insignificant, whereas only the coefficient of the variable controlling for the position of the founder as chairman is negative. Thus, we find only a weak relationship between the founder supervisory position and CEO turnover. The interaction term that controls for the position of founder as chairman of the supervisory board indicates that the founder may oppose a CEO turnover. We do not find, however, such a relationship when the founder is only a member of the supervisory board. We assume that a founder, who is only a member of the supervisory board, does not have substantial influence on the management of the company any more. The founder role is more likely to be one of adviser or honorary member. Hence, we argue that the power of a founder to influence CEO turnover declines depending on the founder's function within the firm.

Table 5

Table 6 shows the results of estimation where the performance variable is the firm's stock market return. Once again, we find that the relationship between turnover and stock return is much weaker than the relationship for ROA. The coefficient of stock market return is negative in all the specifications but statistically insignificant. At the same time, the coefficient of the

variable proxying insider ownership is negative and statistically significant at least at the 5% level.

Using stock market return as the performance measure does not change the sign or magnitude of the coefficients of the variables controlling for the founder position as CEO or executive board member, respectively. In line with the previous results, we find that the coefficients for the founder-CEO and founder executive board member are negative and statistically significant at the 1% and 5% levels, respectively. Moreover, we find that the coefficients of the variable controlling for the position of founder as chairman or as supervisory board member are negative, and the first is statistically significant at the 5% level. Hence, the results confirm that a founder chairman influences the decision to dismiss an outsider CEO. Our results are in contrast to (Lausten, 2002) who shows that the likelihood of CEO turnover increases following a bad year if the chairman of the board is an insider within the firm. We also again find that if the founder is a member of the supervisory board, there is a negligible effect on the decision to fire the CEO. The coefficient is not only insignificant but the marginal effects are close to zero. Moreover, we find that when controlling for the position of founder within the firm, the relationship between turnover and performance measured by the stock market return is weak as shown by the statistically insignificant interaction terms. We attribute this finding to the weak relationship between stock market return and CEO turnover as shown in Table 2.

Table 6

4.4. CEO turnover and transition to the supervisory board

In two-tiered board governance systems, it is not uncommon for CEOs to become a member of the supervisory board. On the one hand, the former CEO has unique expertise that qualifies them as an efficient monitor of management. On the other hand, the CEO will monitor the decisions of the executive board, which he probably created and recently left. As a consequence, the transition of a former CEO to the supervisory board is a controversial topic in the governance literature ([Gerner-Beuerle, 2017](#)). Many countries introduced a cooling-off period for former top executive members' as a component of their corporate governance codes of best practice. In such cases, for a period of given years – on average three to five – former CEOs do not join the supervisory board. It is assumed that the cooling-off period mitigates a potential conflict of interests between former and current CEOs. In practice, however, the decision is made by the shareholders who can ignore best practice recommendations emerging during the cooling-off periods.

Therefore, in practice, former CEOs are often elected as members of the supervisory board. Because of their strong position, former CEO's are also elected as chairman of the supervisory board by the other supervisory board members – close to 50% in our sample. The proportion of former CEOs elected as chairman is similar to the proportion reported for Germany, which also has a two-tiered board governance system [Andres et al. \(2014\)](#). The chairman has a relatively strong position on the supervisory board as the chairman calls the meeting and sets up the agenda. Moreover, [Bresser and Thiele \(2008\)](#) find that, in Germany, a firm's current CEO is more likely to be dismissed following poor performance when a former CEO is the chairman

of the supervisory board. Hence, it is not surprising that our results show a strong relationship between the position of founder chairman and CEO turnover.

Table 7 shows the results where the dependent variable takes the value of one if the CEO turnover results with a transmission of the CEO to the firm's supervisory board. In contrast to previous results, we find that CEO turnover connected with the exiting CEO's transmission to the supervisory board is not strongly related to company performance. Table 7 shows that the coefficients of the performance variable ROA are negative yet statistically insignificant in all the specifications. This result implies that past performance of the company is not the main determinant for the decision to dismiss the CEO and elect them to the supervisory board. Our results supplement the findings of [Brickley et al. \(1999\)](#), who show that the better a firm performs in the years prior to the CEO's departure, the more likely it is that the former CEO will be offered board positions both in his own firm and in other firms. Consequently, [Brickley et al. \(1999\)](#) argue that poorly performing CEOs are not only more likely to lose their jobs, they are also less likely to hold board seats after they leave office.

Interestingly, we find that transmission is less likely when the fired CEO is founder of the company. The coefficient of the variable for founder-CEO is negative and statistically significant at the 5% level. Moreover, the interaction term between the variables F-CEO and the performance variable is statistically significant at the 5% level. On the one hand, the results confirm that removing a founder of a company might be difficult if the founder is the CEO. On the other hand, the results indicate that if the founder-CEO

is fired, they are also less likely to be offered a transition to the supervisory board. We find that the coefficient for insider shareholding is negative yet statistically insignificant in all the specifications. This implies that insider shareholding does not determine CEO transmission to the supervisory board.

Table 7

We find similar results when stock market return is used as the performance variable. Table 8 shows the results. Once again, the coefficient for the performance variable is negative yet insignificant in all the specifications. The only significant coefficient is for the variable for founder-CEO, which is again negative, as well as the interaction term between the variable and the performance variable. The results confirm the special role of the founder within the company. At the same time, we find that being a founder-CEO does not guarantee transmission to the supervisory board.

Table 8

4.5. Robustness

To check the robustness of our main results, we conducted a wide array of additional analyses; however, for brevity, we do not report them¹. First, we checked the consistency of the results after dropping from the sample all the firms from the financial industry. We find that dropping the financial firms from the sample does not affect either the significance level or the sign of the estimated coefficients. Second, we employed alternative performance measures as return on equity, return on assets calculated as earnings before

¹These robustness results are available on request.

interests and taxes (EBIT) to total assets, or year-to-year changes in EBIT. Using the alternative dependent variables, we still find a significant and negative relationship between firm financial performance and CEO turnover. Third, we decided to use all the dependent variables as lagged by one period in all the specifications. The results for firm performance and the control variables are statistically weaker as we show in Table 2, yet the coefficients do not change the signs and their economic meaning.

The results of the robustness test using different methodology, data, and variables confirm our findings concerning the strong link between CEO turnover and firm performance controlling for the different positions of the founder within the firm. However, as in other studies, our empirical analysis has its limitations. Our study does not determine who can fire a founder-CEO when the firm is underperforming. We leave this problem, however, for the future.

5. Discussion and conclusions

There is considerable interest in the role of founders in the development of their companies, particularly when the founder-CEO is forced to resign. In this study, we explore the role of a founder within a firm and their influence on outsider CEO turnover. We use data from a developing economy, characterized by a low level of governance standards. Consequently, our environment differs significantly from existing studies on CEO turnover, which is seen as an important internal governance mechanism.

We find a negative relationship between CEO turnover and firm performance given the accounting return in the current year. The results are weaker, however, when we use the market return as a performance indicator, in line with

the literature. We also confirm that firing a founder-CEO may be difficult. This is consistent with [Flickinger et al. \(2016\)](#), who find that within the German two-tier board context, the social status of a CEO plays a significant role in dismissal decisions following poor firm performance. The authors argue that a dismissal of a well-connected CEO implies a loss of control over critical network resources. Thus, underperforming CEOs with a higher social status relative to the chairman are less likely to be dismissed. A similar argument could explain the weaker relationship between founder-CEO turnover and firm performance.

Consistent with the managerial entrenchment hypothesis, we find that insider ownership hinders the dismissal of outsider CEOs following poor firm performance. Conversely, insider ownership of a founder increases the founder's chances of being dismissed as CEO after poor firm performance. We attribute these contradictory results to the differences in personal goals of the outsider CEO and founder-CEO. An outsider CEO is mainly interested in increasing their personal wealth or status and may use ownership to postpone their dismissal. In contrast, a founder is strongly attached to his/her firm and may decide to sacrifice personal wealth for the firm's success. Moreover, we assume that a founder's personal wealth as a shareholder is linked to the firm's performance, which may explain our results. Thus, a founder-CEO's decision to resign may create welfare for him and other shareholders.

We find, however, that founders do not seem to play an efficient role as monitor. If the founder remains on the executive board, the likelihood that a poor-performing CEO will be dismissed declines. We attribute this to a possible personal relationship between the current CEO and founder, which

may determine the founder's decision. This personal relationship could also explain why founders do not seem to be efficient monitors when they are members of the supervisory board. This result could explain why former founder-CEOs are less likely to become members of the supervisory board. However, we urge care in interpretation because we focus only on forced CEO turnover including founder-CEOs. [Brickley et al. \(1999\)](#) show that poorly performing CEOs are more likely to lose their jobs and less likely to hold board seats after they leave office. Hence, our results support the existing literature, and it is also not surprising that a poor-performing founder-CEO does not receive a seat in the supervisory board despite possessing unique company knowledge.

In summary, the present study demonstrates the strong role of the founder on the primary internal governance mechanism—CEO turnover. We find that dismissing a founder-CEO or a CEO that may be related to the founder may be difficult. We also document that founders' interests may align with the interests of the shareholders. However, founders do not seem to be effective monitors of the current CEO. Future research could expand upon this contradictory relationship to determine under what conditions the power of a founder within the firm increases or decreases. We leave this subject for future research partly because of the limitations of our data and the scope of the current study.

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Table 1: Summary statistics

Summary statistics for the variables used in the analysis for the period 1995 to 2014. *CEO Turnover* and *F-CEO Turnover* is a binary variable that takes the value of one if the CEO or founder-CEO leaves his/her firm during the year, respectively; *CEO to Board* is a binary variable that takes the value of one if the CEO is the founder and leaves their firm for the supervisory board during the year, *CEO S'holder* and *Insider S'holder* is a dummy variable that takes the value one if the CEO or executive board member holds shares in the company, respectively; *F-CEO*, *F-Chair*, *F-MGT*, and *F-NED* are dummy variables that takes the value of one if the founder is CEO, Chairman, executive or supervisory board member, respectively; *ROA* is profit before taxes over total assets; *Return* is annual stock returns adjusted for dividend and stock split; *M/B* is the ratio of market value to book value; *Leverage* is total debt over total assets; *Size* are logs of total assets (in PLN).

Variable	Mean	Std. Dev.	Min.	Max.	N
CEO Turnover	0.141	0.348	0	1	3013
F-CEO Turnover	0.013	0.113	0	1	2772
CEO to Board	0.019	0.138	0	1	3302
CEO S'holder	0.254	0.435	0	1	3174
MGT S'holder	0.11	0.313	0	1	3173
F-CEO	0.267	0.442	0	1	2860
F-Chair	0.11	0.312	0	1	2858
F-MGT	0.136	0.342	0	1	2863
F-NED	0.105	0.306	0	1	2862
ROA	0.047	0.16	-4.269	1.353	2944
Market return	0.219	0.925	-0.962	20.602	2598
Market to Book	2.527	24.687	0.113	1297.788	2918
Leverage	0.446	0.276	0.003	5.884	2839
Size	12.985	2.82	4.277	29.187	2958

Table 2: CEO Turnover

This table reports the results of the probit regressions and marginal effects that are evaluated at the average of the data. The dependent variable is a binary indicator for forced CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	Mfx	(2)	Mfx	(3)	Mfx	(4)	Mfx
ROA	-1.389*** (0.329)	0.293						
L.ROA			-0.423* (0.245)	-0.093				
Return					-0.117** (0.055)	-0.024		
L.Return							0.027 (0.042)	0.006
M/B	-0.010* (0.006)	-0.002	-0.014 (0.015)	-0.003	-0.016 (0.016)	-0.003	-0.041 (0.027)	-0.009
Leverage	0.311 (0.193)	0.066	0.353* (0.200)	0.078	0.643*** (0.211)	0.133	0.641*** (0.219)	0.137
Size	-0.007 (0.013)	-0.001	-0.018 (0.013)	-0.004	0.004 (0.015)	0.001	-0.002 (0.015)	-0.000
Observations	2426		2164		2080		1903	
Pseudo R^2	0.0536		0.0436		0.0467		0.0468	

Table 3: Founder CEO Turnover

This table reports the results of the probit regressions and marginal effects that are evaluated at the average of the data. The dependent variable is a binary indicator for forced founder CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	Mfx	(2)	Mfx	(3)	Mfx	(4)	Mfx
ROA	-0.373 (0.250)	-0.025						
L.ROA			-0.129 (0.284)	-0.008				
Return					-0.260** (0.119)	-0.017		
L.Return							-0.211* (0.127)	-0.014
M/B	-0.017 (0.027)	-0.001	-0.039 (0.042)	-0.003	-0.007 (0.008)	-0.000	-0.010 (0.017)	-0.001
Leverage	0.566* (0.318)	0.037	0.549 (0.340)	0.036	0.729* (0.375)	0.048	0.804** (0.383)	0.052
Size	-0.013 (0.025)	-0.001	-0.004 (0.025)	-0.000	-0.030 (0.027)	-0.002	-0.024 (0.027)	-0.002
Observations	1976		1741		1646		1500	
Pseudo R^2	0.064		0.071		0.090		0.097	

Table 4: CEO Turnover and Insider Ownership

This table reports the marginal effects of probit models that are evaluated at the average of the data. The dependent variable is a binary indicator for forced founder-CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	(2)	(3)	(4)
ROA	-0.285*** (0.074)	-0.016 (0.015)		
ROA × CEO S'holder	0.001 (0.202)	-0.109* (0.056)		
Return			-0.026** (0.012)	-0.017* (0.009)
Return × CEO S'holder			0.010 (0.026)	-0.001 (0.015)
CEO S'holder	-0.120*** (0.022)	0.019** (0.009)	-0.119*** (0.023)	0.015 (0.010)
M/B	-0.002 (0.001)	-0.001 (0.001)	-0.003 (0.003)	-0.000 (0.001)
Leverage	0.056 (0.040)	0.038* (0.022)	0.129*** (0.043)	0.049* (0.026)
Size	-0.002 (0.003)	-0.001 (0.002)	-0.000 (0.003)	-0.002 (0.002)
Observations	2412	1962	2068	1634
PseudoR2				

Table 5: CEO Turnover and Founder as Monitor (ROA)

This table reports the marginal effects of probit models that are evaluated at the average of the data. The dependent variable is a binary indicator for forced CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	(2)	(3)	(4)
ROA	-0.242*** (0.079)	-0.352*** (0.085)	-0.246*** (0.079)	-0.283*** (0.077)
ROA × F-CEO	-0.225 (0.190)			
ROA × F-MGT		0.217 (0.291)		
ROA × F-Chair			-0.263 (0.575)	
ROA × F-NED				-0.329 (0.229)
ROA × S'holder	0.091 (0.193)	0.071 (0.157)	0.017 (0.177)	0.068 (0.174)
F-CEO	-0.101*** (0.024)			
F-MGT		-0.066*** (0.025)		
F-Chair			-0.062 (0.045)	
F-NED				0.009 (0.030)
Insider S'holder	-0.070*** (0.022)	-0.110*** (0.022)	-0.111*** (0.021)	-0.112*** (0.021)
M/B	-0.002 (0.001)	-0.002* (0.001)	-0.002 (0.001)	-0.001 (0.001)
Leverage	0.052 (0.041)	0.050 (0.041)	0.050 (0.040)	0.036 (0.038)
Size	-0.002 (0.003)	-0.001 (0.003)	-0.001 (0.003)	-0.002 (0.003)
Observations	2211	2194	2202	2194
Pseudo				

Table 6: CEO Turnover and Founder as Monitor (Stock Return)

This table reports the marginal effects of probit models that are evaluated at the average of the data. The dependent variable is a binary indicator for forced CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	(2)	(3)	(4)
Return	-0.019 (0.012)	-0.019 (0.013)	-0.014 (0.012)	-0.012 (0.011)
Return \times F-CEO	-0.049 (0.037)			
Return \times F-MGT		0.017 (0.041)		
Return \times F-Chair			-0.049 (0.052)	
Return \times F-NED				-0.089** (0.043)
Return \times S'holder	-0.004 (0.030)	-0.019 (0.027)	-0.018 (0.028)	-0.015 (0.027)
F-CEO	-0.102*** (0.025)			
F-MGT		-0.060** (0.024)		
F-Chair			-0.076** (0.034)	
F-NED				-0.002 (0.031)
Insider S'holder	-0.055** (0.023)	-0.091*** (0.022)	-0.093*** (0.022)	-0.095*** (0.021)
M/B	-0.003 (0.003)	-0.004 (0.004)	-0.003 (0.004)	-0.004 (0.004)
Leverage	0.108** (0.044)	0.121*** (0.046)	0.108** (0.043)	0.106** (0.043)
Size	0.000 (0.003)	0.001 (0.003)	0.000 (0.003)	0.001 (0.003)
Observations	1923	1917	1914	1917
Pseudo				

Table 7: CEO transition to Supervisory Board (ROA)

This table reports the marginal effects of probit models that are evaluated at the average of the data. The dependent variable is a binary indicator for forced CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	(2)	(3)	(4)
ROA	-0.016 (0.012)	-0.005 (0.014)	-0.047 (0.039)	-0.061* (0.036)
ROA × F-CEO		-0.156** (0.066)		
ROA × F-MGT			-0.027 (0.023)	
ROA × F-Board				-0.019 (0.015)
ROA × S'holder	-0.016 (0.045)	0.051 (0.048)	0.020 (0.056)	0.032 (0.055)
F-CEO		-0.021** (0.010)		
F-MGT			0.001 (0.011)	
F-Board				0.012 (0.009)
Insider S'holder	-0.005 (0.008)	0.005 (0.008)	-0.003 (0.009)	-0.006 (0.009)
M/B	-0.000 (0.000)	-0.001 (0.001)	-0.000 (0.001)	-0.000 (0.000)
Leverage	0.011 (0.015)	0.007 (0.018)	0.007 (0.020)	0.007 (0.018)
Size	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
Observations	2301	1907	1652	1914
Pseudo				

Table 8: CEO transition to Supervisory Board (Stock Return)

This table reports the marginal effects of probit models that are evaluated at the average of the data. The dependent variable is a binary indicator for forced CEO turnover. All variables are as defined in Table 1. All regressions include a constant, industry, and year fixed effects. Robust standard errors clustered at the firm level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% level, respectively.

	(1)	(2)	(3)	(4)
Return	-0.008 (0.008)	-0.006 (0.008)	-0.005 (0.007)	-0.006 (0.007)
Return × F-CEO		-0.043* (0.023)		
Return × F-MGT			-0.023 (0.025)	
Return × F-Board				-0.015 (0.018)
Return × S'holder	-0.009 (0.015)	0.001 (0.013)	-0.007 (0.014)	-0.006 (0.015)
F-CEO		-0.029** (0.012)		
F-MGT			0.000 (0.011)	
F-Board				0.011 (0.008)
Insider S'holder	-0.004 (0.008)	0.009 (0.009)	-0.002 (0.009)	-0.005 (0.008)
M/B	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.001)	-0.000 (0.000)
Leverage	0.010 (0.018)	0.003 (0.019)	0.008 (0.019)	0.010 (0.017)
Size	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
Observations	1921	1640	1659	1921
Pseudo				

Appendix A.

Table A1: Distribution of the sample

Sector	No. of firms	Obs.	Percent
automobiles	6	62	1.88
banking	13	163	4.94
building materials	12	107	3.24
capital market	4	16	0.48
chemicals	6	23	0.7
construction	28	276	8.36
developers	24	213	6.45
electroengineering	26	265	8.03
energy	6	52	1.57
finance other	25	222	6.72
food	24	229	6.94
hotels & restaurants	7	67	2.03
insurance	1	4	0.12
it	26	244	7.39
light	9	94	2.85
media	16	118	3.57
metals	17	181	5.48
oil & gas	3	30	0.91
other industries	4	20	0.61
other services	31	205	6.21
pharmaceutical	10	78	2.36
plastics materials	8	74	2.24
retail trade	20	184	5.57
telecom	5	67	2.03
wholesale trade	23	233	7.06
wood & paper	5	75	2.27
Total	359	3,302	100