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THE INFLUENCE OF NETWORKS ON CEO TURNOVER, APPOINTMENT AND COMPENSATION

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ABSTRACT

CEO appointments, working and compensation are only some of the CEO labor market outcomes that I analyze. For this reason, I make a distinction between the CEO's overall connectedness and the strength and structure of the CEO's individual connections to the board. In my research, I've discovered that both types of interdependence contribute to conventional measures of turnover and pay in separate and very important ways. Deepening CEO ensconcement is facilitated by specialized connections. The likelihood of a CEO leaving, the sensitivity of the company to CEO turnover in terms of performance, and the speed with which a former CEO can find new employment all increase as the CEO's overall network size grows. If a corporation opts to hire an outsider for the position of CEO, having connections to the board of directors increases the candidate's chances of being selected. Last but not least, CEOs that have stronger overall connections earn more money. The research reveals that a chief executive officer's (CEO) ties outside of the current company's board of directors have a significant and distinct economic impact on the company's bottom line.

***Keywords**: CEO turnover; CEO compensation; Social Networks.*

INTRODUCTION

Technology advancements have made networking an integral aspect of daily living and commercial operations. In contrast to their infancy in the early 2000s, social networking platforms like Facebook, LinkedIn, and Twitter now have hundreds of millions of users worldwide. Researchers' interest in the effect of networks on economic outcomes is high and rising. This study examines the significance of CEOs' social networks in the context of the job market.

The CEO's hiring, firing, and retention, as well as compensation, are all heavily influenced by the CEO's network. The board of directors may be unable to monitor the CEO or discipline him or her fairly and efficiently if there are ties between the CEO and the board. Hwang and Kim (2009) and Kramarz and Thesmar both find that boards with members who have close personal or professional ties to the chief executive officer are more likely to retain an underperforming CEO or approve of excessive compensation. Furthermore, the CEO's social capital and chances for employment outside the company are reflected in the quality and organization of his or her total connections. A CEO with more connections will have an easier time finding a new role after leaving their current company. Therefore, the CEO turnover and compensation may be affected by general connectivity in ways that are distinct from the pairwise specific CEO-board connectedness. The overall connection has been largely ignored by previous empirical investigations of CEO and director networks. This article demonstrates that the board's ability to fire the CEO, select a new CEO, and determine the CEO's salary depends on both types of connection.

First, I look at how the CEO's network influences the probability of a leadership change. As for the turnover-performance sensitivity, I discover that it is lower when there are linkages between the CEO and the board directors. This data reveals that a CEO with ties to the board is likely to remain in his current role despite his bad performance. On the other hand, the likelihood of CEO turnover and the sensitivity of the turnover to performance are both increased by the CEO's general connection. This finding suggests that an increase in opportunities outside the company makes it simpler for the CEO to resign. The current CEO has less reason to fight the board's disciplinary replacement decision now that he or she has stronger job security.

The next logical inquiry is whether the CEO's external opportunities are accurately reflected by the overall connection measurements. My second hypothesis test looks at how the new role the former CEO has taken affects his network. After a CEO leaves a company, I've found that those with more ties to the network are more likely to be promoted to senior positions or given board seats. The former CEO's pairwise ties to the old company's board of directors, however, may not bode well for his or her prospects of finding suitable employment elsewhere. Previous research, such as those of Hwang and Kim (2009), ignores the specific effect of general connection on CEO outside opportunities, which is highlighted by this conclusion.

I then move on to discuss the topic of CEO succession. I examine if a candidate's connection is a factor in their likelihood of being chosen as the new CEO, controlling for other observable features of CEO candidates. I find that pairwise connectivity between the CEO candidate and the board of directors increases the likelihood of appointment for the subsample of companies that choose to recruit an outsider as the new CEO. This outcome accords with survey data indicating that boards of directors are an important resource for corporations seeking an external CEO. The board's confidence in the candidate increases if they know someone on it. I find that a candidate's overall connectivity has a negative effect on the chance of appointment for the subsample of organizations who opt to promote an insider as the new CEO. Hiring a CEO who is also actively involved in several networking events seems to carry more risks than any potential rewards.

Finally, I look into whether or not the CEO's social network is responsible for compensation. Again, I make a distinction between the CEO's specific closeness to the board and the CEO's general connectedness. There may be separate effects from each of them. The closeness of the board members to the CEO, which increases the likelihood of pairwise connections, could lead to a raise in CEO pay. The CEO's human capital value can be increased by the market's recognition of his or her general connection, which represents the CEO's external opportunities. The overall connectivity has a greater effect on CEO salary than the pairwise closeness, as shown by my research. If only the CEO-board connections are taken into account, then the greater pay obtained by well-connected CEOs could be wrongly attributed to director nepotism.

LITERATURE

Huson, Mark R., Robert Parrino, and Laura T. Starks. "Internal monitoring mechanisms and CEO turnover: A long-term perspective." *the Journal of Finance* 56.6 (2001): 2265-2297. We present data on the turnover rate of chief executive officers (CEOs) from 1971 to 1994. Our research shows that CEO turnover has evolved throughout time. There was a rise in the rates of both forced CEO turnover and external succession. Despite major shifts in corporate governance procedures, we find no evidence that the association between forced CEO turnover and business performance weakens over the course of the time period we analyze. There is no correlation between the sensitivity of CEO turnover to business performance and the strength of the takeover market, according to the data.

Bhagat, Sanjai, Brian J. Bolton, and Ajay Subramanian. "CEO education, CEO turnover, and firm performance." Available at SSRN 1670219 (2010). CEO education, CEO turnover, and company performance are all factors examined in this paper. Our primary focus is on whether or not a CEO's level of education is a significant predictor of future performance, how it influences the selection process for a new CEO, and whether or not a company decides to replace its present CEO. The education of a CEO is evaluated based on six primary metrics, including the CEO's undergraduate alma mater, the CEO's possession of an MBA, a law degree, or a master's degree, and the MBA's or law degree's accreditation from a Top-20 program. Between 1993 and 2007, our sample size covers more than 14,500 CEO-years, and we document more than 2,600 instances of CEO turnover.

There have been a few recent studies that examine how social networks influence CEO remuneration and turnover. Hwang and Kim (2009), in a related paper, find that companies with boards that have social ties to the CEOs award significantly higher levels of compensation, exhibit weaker pay-performance sensitivity, and have a lower probability of CEO turnover. This research differs from those others by asking different questions, employing alternative measures of connection, and expanding beyond the Fortune 100. Hwang and Kim examine the impact of a new measure of board independence that accounts for social links on the efficiency of board monitoring. I take a CEO's-eye-view of the situation and investigate how various degrees of networking impact CEOs' chances of finding and keeping a job. To quantify the likelihood of a social connection between the CEO and the board directors, previous authors have defined social links in terms of shared background, such as the same regional origin or academic discipline. When two people work as directors or executives for the same company at the same time, there is a greater chance that they will have meaningful encounters that will result in information useful to the CEO. In addition, I distinguish between two types of connectedness—general and specific—whereas the earlier authors do not make this distinction. I also include updated information about the current CEO and the roles held by the previous two CEOs.

One section of this research contributes to the literature on factors that influence CEO turnover. The authors Warner, Watts, and Wruck (1988) analyze the correlation between stock performance and executive turnover (CEO, President, and Board of Directors positions). Stock price declines are found to correlate negatively with the likelihood of a change in the company's senior management. Similar findings about CEO turnover are documented by Weisbach (1988). He notes that the chance of a change in CEO is inversely related to accounting success as well as stock returns. In addition, he discovers that organizations with boards controlled by outsiders have a greater turnover-performance relationship. In this study, I present and discuss the significance of network connection as a new factor in CEO turnover. More recently, Parrino (1997) discovers that industries with similar firms have a higher probability of turnover than heterogeneous industries. His main argument for why a CEO should be replaced is the presence of a qualified outside contender. I would add to this, albeit from a somewhat different perspective, by saying that the CEO's access to high-quality opportunities outside the company is also crucial to understanding why and when CEOs leave their posts. CEO turnover is studied by Huson, Parrino, and Starks (2001), who look at data from 1971–1994. Despite major shifts in corporate governance structures and the ferocity of the takeover market, they find no significant shifts in the turnover-performance relationship over the course of the time they analyze. My research demonstrates that the CEO's network has a significant impact on understanding the correlation between turnover and performance over time.

Kim, E. Han, and Yao Lu. "The independent board requirement and CEO connectedness." Available at SSRN 1970591 (2011). The chief executive officer (CEO) may try to mitigate the increased independence of the board that is mandated by regulation by increasing the board's connectivity to other key players in the firm's governance. We find that the rule mandating an independent board led to a rise in the number of top executives appointed (FTA) during the tenure of the current CEO, with the newly appointed executives displaying a greater number of preexisting network linkages to the CEO. The stronger the ties, the less of an impact the regulation tends to have. When FTA legislation is binding, meaning that companies are limited in their ability to increase pay for top executives, CEO pay decreases, pay is more closely tied to performance, forced CEO replacement is more likely when performance declines, and Tobin's Q rises. We find the opposite to be true when companies have flexibility to boost FTA to fight the regulation: increased CEO remuneration, decreased sensitivity to pay for performance, decreased sensitivity to forced CEO succession, and decreased Q. The CEOs of these businesses become more firmly planted in their executive suites as a result of the new rules, which weakens oversight and reduces shareholder value.

CEO TURNOVER AND NETWORKS

Decisions on CEO turnover

A CEO's departure has far-reaching consequences for a corporation. Previous research has highlighted executive age and prior business performance as key determinants influencing CEO turnover decisions (e.g., Murphy (1999) and Kaplan and Minton (2006)). Networks, in my opinion, are an additional predictor of turnover. There are at least two reasons why the incumbent CEO's networks could be influential. On the one hand, a CEO with social ties to the board of directors may become entrenched in the job even if it is not in the best interests of the shareholders. On the other hand, a CEO who is highly connected in the network of other top-level executives and directors will have more outside opportunities. Because there are competitive options elsewhere, such a CEO may protest less fiercely when pressured to resign, and he may even voluntarily depart for an attractive new post. The former is due to the CEO's links to the board members who are expected to supervise and discipline him, while the latter is due to the CEO's position in the entire corporate network. Both impacts are empirically investigated in this study.

I begin by reviewing all of the CEO-company-year observations reported in Board Ex. Regulated companies (utilities and financial firms) are removed from the sample since their CEO turnover decisions may be substantially influenced by the government.2 Furthermore, for an observation of company j in year t to be included in any of the samples, the accounting and stock return of company j for the fiscal year ended in year t must be accessible 1. Furthermore, the CEO's tenure at business j must have begun no later than t 1, ensuring that the CEO was responsible for the company's performance prior to the event year. The generated sample includes 40,208 CEO-firm-year observations from 1991 to 2007. It involves 5,160 businesses and 7,447 CEOs. There are 4,445 turnover events, representing 11.06% of total observations.

New Role for Former CEO

CEO overall connectivity and CEO-board pairwise connectedness have different effects on CEO turnover, as shown in the previous section. The rationale rests in the dissimilar effects they have on the subsequent careers of former CEOs. To emphasize the distinction, I look at the factors that led former CEOs to their current roles.

Specifically, I use multinomial logit models with a dependent variable that can take the values 0, 1, and 2, which stand for "no new position," "outside top business positions," and "other positions," respectively. The CEO's age, MBA degree, and the size and industry-adjusted stock return of the company the CEO previously led are all explanatory factors, as is a dummy reflecting the CEO's link to the board of directors. One of the four measures of centrality is employed in each specification. I also account for year and industry fixed effects. The data utilized in these regressions are summarized in the right panel of Table 3b. When compared to the overall sample's summary statistics, the CEOs who have stepped down have higher centrality scores, are older, and come from larger, less successful businesses. This supports the conclusions of the regression analysis shown previously.

In sum, the former CEO is able to continue working thanks to his or her ties to the board of directors. The linked ex-CEO usually remained with the company in some capacity, often as a director or an executive. However, in contrast to external connections, internal ones do not improve the former CEO's chances of landing another top position elsewhere. Consistent with the preceding section's findings, the CEO's extended network opens up new professional doors.

NETWORKS AND THE APPOINTMENT OF NEW CEOS

After a CEO leaves, the board of directors must make the critical decision to replace them. Evidence on the elements that influence a corporation's choice of whether to hire from within or outside the company may be found in empirical research like Parrino's (1997, for example).

However, nobody seems to be thinking too much about who would win out in the end. Here, I delve into the potential influences on CEO hiring decisions, with a special emphasis on the importance of candidates' networks.

A CEO candidate's chances of landing the job are thought to increase if he or she has personal connections to members of the hiring board. Khurana (2000) conducted a field study on the CEO search process and found that directors, candidates, and executive search companies all believe that board member references are crucial to the appointment of the CEO. Many board members have held the position of CEO or another top executive in the past and can provide recommendations for qualified applicants.

However, the expected outcome of widespread interconnection is not as simple. On the plus side, a company may be more interested in employing a well-connected individual if his connections could help the organization secure funding or new business partnerships. On the other hand, the board of directors can be concerned about the CEO's ability to devote sufficient time and effort to the company. Fich and Shivdasani (2006) demonstrate that external directors who are already stretched thin are ineffective watchdogs. Similarly, CEOs who spend a lot of time networking may be less focused on running the business's essential functions. In addition, data presented in Section 5 suggests that CEOs who score higher on centrality metrics are more likely to be replaced. Companies may be hesitant to hire such individuals due to concerns about retention and minimizing future search expenditures. There has yet to be any empirical research into what role connections play in picking CEOs.

COMPENSATION FOR CEOS AND NETWORKS

The level of CEO compensation and its components have piqued the interest of the general public and academics alike. The CEO's networks can boost CEO compensation in a variety of ways. On the one hand, board members having social ties to the CEO are more likely to be generous in determining CEO pay because of their attachments to the CEO. On the other hand, according to my research, connected CEOs have more outside prospects for top jobs in other organizations, increasing the worth of their human capital. They are better protected from idiosyncratic firm risk because of their employment market safety net. According to contract theories, I anticipate that they will include more stock-based incentives in their remuneration packages.

I run OLS models to investigate the effect of networks on CEO compensation. In order to make conclusions about the size and mix of CEO remuneration packages, I look at two compensation components separately: stock-based compensation and salary. Because the compensation variables are skewed, all three dependent variables are log-transformed. The CEO's centrality measures and the CEO-board relationship dummy are the main explanatory factors. I account for three CEO characteristics: age, tenure, and MBA education, as well as three company characteristics: age, risk, and performance. In addition, I account for year and industry fixed effects. The standard errors are stable and grouped by year.

CONCLUSION

The CEO labor market is naturally influenced by networking. Motivated by social capital and agency theories, this article takes an exploratory approach, assuming that the structure or pattern of social ties between corporate executives and directors is relevant to major corporate decisions on CEO turnover, CEO hiring, and CEO compensation. I analyze many characteristics of CEO networks and experimentally test their economic consequences using a large data set. I distinguish between the strength and structure of the CEO's overall connection and the pair-wise specific CEO-board connectedness.

I analyze the professional ties between board members and the CEO they are supposed to monitor by building annual networks out of board directors and declared incomes of various companies from 1990 to 2012. In addition, I employ four indicators of one's standing in the professional world as a whole. Each metric provides a unique viewpoint on interdependence. I investigate whether, how, and in what direction these factors influence CEO turnover, the career prospects of outgoing CEOs, the hiring of new CEOs from within and without the organization, and the size and composition of CEO remuneration packages.

This research provides evidence that suggests that networks contribute to more conventional measures of economic success, such as turnover and pay, in important ways. They are also pivotal in choosing the company's top executive. Consistent with prior research, CEO-board social ties may be an indicator of poor corporate governance. The general connectivity, on the other hand, functions in ways that might be viewed as a form of useful social capital. In addition, the research presents illuminating contrasts between the effects of various degrees of connectivity. These are fresh empirical findings uncovered by data, and they provide formidable obstacles to the progress of theory.

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