THEIR REPUTATIONS PRECEDE THEM: THE CEO SUCCESSOR'S REPUTATION AND SHAREHOLDERS' ASSESSMENT OF ADVERSE SELECTION

A Dissertation

by

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ABSTRACT

The CEO succession process is essential to the continued success of a firm; however, although theoretical work exists few empirical studies have been empirically examined questions regarding the firm's adverse selection or the effect that reputation has on the perception of adverse selection by shareholders. The process of CEO selection lacks transparency for those outside the firm; what is known about the process is largely anecdotal. In this dissertation, I examine the effects that reputation has on the perception of adverse selection by using established reputation measures and developing new constructs. I study firms in which a CEO succession event has occurred and the newly appointed CEO has prior experience as a CEO. The hypotheses are tested using event study analysis.

Using a sample of 189 firms from COMPUSTAT, I find that the CEO reputation for the capability of leadership plays a role in the perception of adverse selection. Specifically, I find that higher CEO reputation for the capability of leadership results in a more positive reaction from the market—fewer market reactions that may signal a perception of adverse selection. Additionally, the reaction to the CEO succession has a stronger positive market reaction to high CEO the reputation for the capability of leadership when the percentage of contingent compensation for the newly appointed CEO is higher.

The results of this study provide limited, but compelling evidence that a positive reputation of the CEO does in fact influence the perceptions about adverse selection.

Specifically, this study advances the concept that a positive CEO reputation for a specific capability, such as a capability of leadership, can diminish the information asymmetry during the CEO selection process, associated with agency theory, for the shareholders. These results suggest that the CEO selection and adverse selection literatures should continue to examine the role of reputation in the CEO selection process. The results of this research should encourage future scholars to test the adverse selection criteria, such as if a CEO has prior experience as a CEO or within an industry that are presented in theory. Research should also continue to develop measures for the CEO and firm reputation based on the information that is available in the market, such as the needs of firm as expressed in the firm's reputation referred to as the going-in-mandate in this research.

DEDICATION

I dedicate this to the exceptional men in my life. You have and continue to be the inspiration for all the good things I do in my life.

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INTRODUCTION

Selecting a CEO successor is among the most important decisions made by a board of directors (BoD) (Tian, Haleblian, & Rajagopalan, 2011; Vancil, 1987); but, the process used to make this selection lacks transparency for firms publically traded within the United States.[1] Under SEC Rule 14a-8(i)7, the BoD may decline to address shareholders' requests for information about the firm's CEO selection process.[2] This rule allows the CEO selection process to remain private, with the BoD possessing proprietary information about CEO selection (Graffin, Carpenter, & Boivie, 2011). In the absence of perfect information as to the CEO selection (e.g., the quality of the CEO and the criteria used to select the CEO) shareholders use available, public information such as a CEO's reputation, the compensation structure for the new CEO, and the hiring firm's reputation to evaluate the potential success of a CEO selection. This set of signals regarding the CEO and the needs of the firm minimizes the shareholders' information asymmetry in relation to the CEO selection process and enables shareholders to determine if the CEO has potential to enhance the market value of the firm (i.e., increase the share price).

A CEO selection may have a significant effect on a firm's performance (Mackey, 2008). The success of this CEO selection is predicated on the ability of the CEO and

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1 This study is based on a sample of United States succession events from 1992-2011. Specifically, this sample included CEO successors with prior experience as a CEO. As legal disclosures concerning governance actions and the presence of outside successors differs from nation to nation, this study may not be generalizable to non-domestic succession events.
2 It is important to note that although agency theory suggests that shareholders take a long term perspective on ownership (Daily, Dalton, & Cannella, 2003; Laverty, 1996), recent literature finds different types of shareholders take different investment strategies (David, Hitt, & Gimeno, 2001). The shareholders considered in this dissertation are not transient owners, but rather those shareholders that take a long term perspective on ownership, such as institutional or dedicated owners.

suitability (or fit) of the CEO to the needs of the firm (Chen & Hambrick, 2012). Specifically, a favorable selection is where the CEO has the ability to meet the short and long term needs of the firm to create value for the firm; in contrast, an adverse selection is where the CEO lacks the ability to meet the needs of the firm, which may result in a loss of share value. Shareholders assess the capabilities of a CEO through the reputation of the CEO presented in the media prior to the succession event.

Thus, the CEO's reputation for the capabilities of leadership and effective strategic management [3] inform the shareholders' perception of a quality CEO selection. CEOs must be able to serve as a leader of the firm and direct effective strategic management of the firm (Finkelstein, Hambrick, & Cannella, 2009). Moreover, the shareholders' perception of a favorable or an adverse selection may be enhanced by the shareholders' perception of the going-in-mandate (operationalized in this study as the media's presentation of the firm's needs), the perception of the CEO capabilities' fit to the going-in-mandate, and the CEO successor's new compensation structure.

The process by which the BoD selects a CEO successor begins by the BoD determining the going-in-mandate, and then selecting a CEO with experiences and credentials that best align with it (Finkelstein et al., 2009; Vancil, 1987; Westphal &

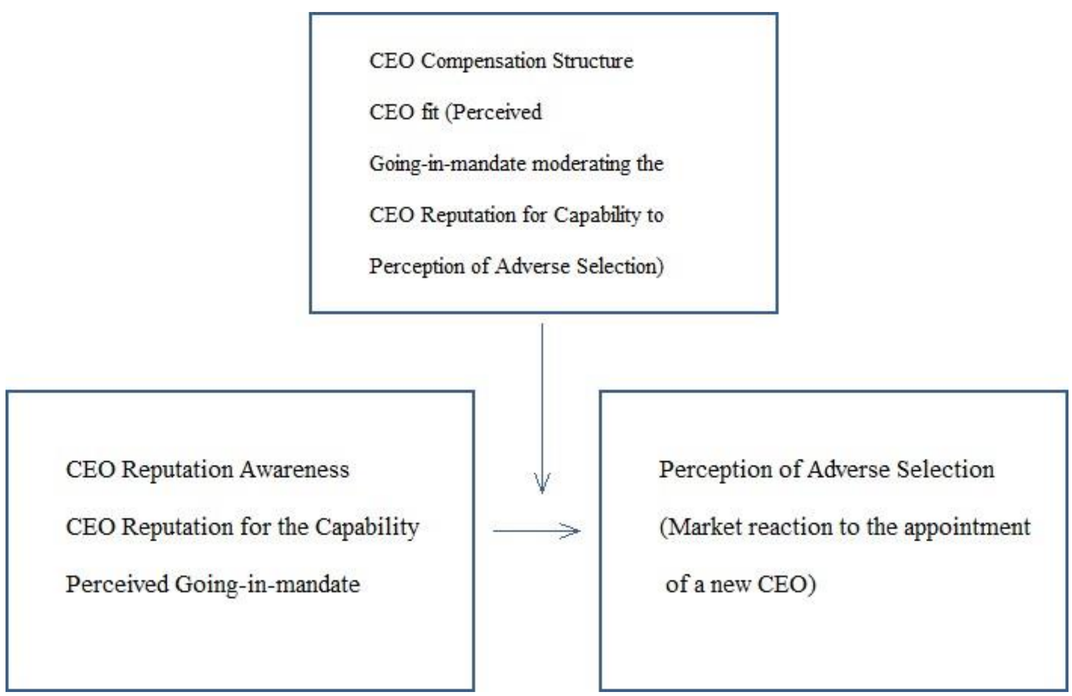
3 The reputation for the capability terminology in this study builds on the work of Mishina, Block and Mannor (2012). These authors introduce terminology for character and capability reputations that parallel the moral hazard and adverse selection problems that are dealt with in agency theory. A reputation for the capability of leadership and strategic management extends the work done by these authors and others that examine heuristics and judgments regarding the reputation of the individual or organization (Carpenter, Pollock, & Leary, 2003; Mishina, Dykes, Block, & Pollock, 2010). The reputation for the capability of leadership and the reputation of the capability of strategic management are chosen for this research because these specific capabilities are essential to the success of a new appointed CEO, such as the CEO skills associated in prior research with effective leadership and effective management of the firm's strategic actions. A negative reputation for a capability would refer to the CEO appearing to lack the capability.

Fredrickson, 2001). The CEO selection process facilitated by the BoD is not transparent to the shareholders, so the shareholders' perception of the CEO's skills and the going-in-mandate are determined through the information disseminated by reputable, large-circulation media sources (Lee & James, 2007). In particular, research has found that shareholders when evaluating a firm's major actions tend to focus on the media representation of the situation, rather than the firm's press releases (Bednar, 2012; Dyck & Zingales, 2002; Miller, 2006). Thus, a firm with a specific negative reputation in the media for the capabilities of leadership and effective strategic management will have a shareholder perceived going-in-mandate for these two capabilities. In this context, where the firm has a perceived going-in-mandate for the capabilities of leadership and effective strategic management, if the CEO does not have a positive reputation for these two capabilities, the shareholders may determine this to be an adverse selection. For example, Meg Whitman who had negative reputation issues while at eBay, was appointed as CEO of Hewlett Packard (Kopytoff, 2011; Anders, 2013). The shareholder reaction to this appointment was negative as suggested by a drop in the Hewlett Packard share price of more than 10 percent in three days surrounding her appointment. Thus, a favorable selection is the positive market reaction to a CEO selection for which the firm has a perceived going-in-mandate and the newly appointed CEO has a reputation for meeting these firm needs, such as was the case with the firm Stride Rite and the appointment of David Chamberlain (Reidy, 1999) and Willis Limited and the appointment of David Martin (Market Watch, 2014).

The perception of adverse selection is an important aspect of agency theory, as the shareholders' market reaction to a CEO selection results in a change in share price that may affect the perceived legitimacy and tenure of the CEO (Ocasio, 1994). Due to the lack of transparency within the succession process, CEO selection is difficult for researchers to study. Prior work on adverse selection, within the agency theory literature, used demographic characteristics to determine a shareholder's judgment as to the favorable or adverse selection of the newly appointed CEO. This research has resulted in mixed findings. Research on CEO succession has called for more qualitative, detailed information regarding the CEO successor's qualifications (Pitcher, Chriem, & Kisfalvi, 2001) and has pointed out the need to quantify the going-in-mandate (Quigley & Hambrick, 2012). Specifically, media reputation can serve as an important signal for reducing information asymmetry between the shareholders and the firm when significant changes to the corporate governance of the firm occur (Bednar, 2012). In the absence of information on CEO quality, perceptions of the CEO (i.e., reputation for capabilities) may serve as a more effective proxy than demographic information for the shareholders to evaluate the favorability of the CEO selection.

This dissertation examines the signals (i.e., the CEO's reputation, the CEO's compensation and the shareholders' perception of the going-in-mandate) as depicted in Figure 1 below that influence a shareholder's assessment of favorable or adverse selection of the CEO. Specifically, I investigate the effect the successor's compensation, the successor's reputation for the capabilities of leadership and effective strategic management, and the perception of the going-in-mandate have on shareholders' reaction to the CEO selection. Additionally, this research examines how the perception of CEO fit based on the CEO's reputation moderated by firm going-in-mandate may enhance or attenuate the shareholders determination of whether the CEO is an adverse selection. Thus, I seek to evaluate the role that signals of information asymmetry and the perception of CEO fit have on shareholders' perception of CEO adverse selection. As such, this research answers a call to develop better measurement of the abilities of the newly appointed CEO (Kesner & Sebora, 1994; Pitcher et al., 2000), and allows for the development of the constructs of CEO reputation and the going-in-mandate. Additionally, this research identifies the signals that may decrease information asymmetry between the firm and shareholders during the CEO selection process and extends the research on CEO fit.

Figure 1. Their reputations precede them



Central to agency theory is the issue of adverse selection, where the BoD makes unfavorable CEO selections because information asymmetry creates difficulty in determining if CEOs have the ability to do the work for which they are compensated (Eisenhardt, 1989; Shane; 1998; Wiersema & Zhang, 2011). The BoD has a fiduciary responsibility to minimize adverse selection and hire an effective CEO (Lan & Heracleous, 2010). However, many factors can reduce the effectiveness of the BoD in fulfilling the fiduciary duty of CEO selection, including information asymmetry between the board and the potential CEO successor (Zhang, 2008), incompetence of the board (Wiersema, 2002; Zhang, 2008), or the BoD selecting a successor due to social connections rather than successor qualifications (Chatterjee & Harrison, 2005). Additionally, the shareholders' assessments of effectiveness may differ from the actual effectiveness of a BoD's actions, such as the CEO selection (Bednar, 2012).Thus, even if a BoD has chosen a capable successor, suitable to the needs of the firm, because the shareholders lack information about the selection of CEO, there is no guarantee that the market will respond positively to the announcement of the CEO appointment (Graffin et al., 2011).

Researchers have examined shareholders' reaction to a succession event, specifically the firm context, the succession process, and the characteristics of the incoming and outgoing CEO (Kesner & Sebora, 1994; Lorsch & Khurana, 1999). Inherent in the studies of market reaction to a CEO selection is the premise that shareholders' perception of adverse selection is important, in that negative reactions to CEO announcements are costly for the firm both in market value and reputation both in the short and long term. Shareholders' reaction to CEO appointments may have a significant short term effect on a CEO's power, the tenure of the CEO and the CEO's perceived legitimacy-where shortened CEO tenure has been found to have longer term effects on firm performance (Blettner, Chaddad, & Bettis, 2012; Ocasio, 1994).

Firms acknowledge the importance of shareholders' reaction to a succession event. For example, shareholders believe that prior experience as a CEO enhances the CEOs ability to serve effectively in another CEO role. Specifically, Graffin and colleagues (2011) found that firms sometimes try to create "strategic noise" by simultaneously releasing confounding information about other significant events when hiring a CEO with no previous CEO or industry experience so as to hide the perception of adverse selection. Conversely, seemingly qualified CEOs, such as outside successors with previous CEO experience are expected to engender a positive market reaction (Finkelstein et al., 2009; Zhang, 2011). However, studies of shareholders' reaction to the outside successor have mixed results. While research has shown that shareholders generally have a positive reaction to the appointment of an outside successor (Harris, Lauterbach, & Vu 1994; Worrell, Davidson, & Glascock, 1993), some researchers find no abnormal returns based upon insider or outsider origin (Furtado & Karan, 1990). Alternatively, Warner, Watts, and Wruck (1988) found that shareholders react negatively to outside successions. This negative reaction to the succession event may be due to the high potential for information asymmetry between the potential outside CEO and the BoD.

The result of the CEO selection process is uncertain, as it is difficult to connect observable CEO characteristics with firm performance (Bok, 1993; Finkelstein et al., 2009; Khurana, 2002a). When the assessment of a firm's actions is uncertain, a number of signals may reduce the shareholders' uncertainty regarding the CEO selection. Signals serve an important purpose in the perception of CEO selection. Shareholders, as the receivers of the signals, have their perceptions of the CEO influenced by the perceived honesty of the signaler, the frequency of the signal, and the signal fit (the extent to which the signal or public information is related to the unobservable or private information) (Connelly, Certo, Ireland, & Reutzel, 2011). Signals are observable and costly (Connelly et al., 2011); however, recent research on information asymmetry has included less costly forms of communication to communicate with the capital markets (Riley, 2001).

Particularly, the signal of media coverage influences the perceptions of the firm's external constituents during uncertain situations (Miller, 2006; Rao, 1994; Rindova, Williamson, Petkova, & Sever, 2005). Reputation in the media affects shareholders' perceptions of the CEO and the firm (Hoffman & Ocasio, 2001; Pollock & Rindova, 2003; Pollock, Rindova, & Maggitti, 2008). In uncertain situations, media reputation is a dominant influence on the shareholders' perceptions of the information about the firm (Deephouse, 2000; Rindova, Pollock, & Hayward, 2006). Shareholders may use reputation, in the absence of perfect information, to draw conclusions about future behavior and performance (Mishina, Block, & Mannor, 2011).

Although the firm reputation definition, "…perceptions about an organization's abilities to create value relative to competitors" (Rindova et al., 2005: 1033), and constructs are well established, researchers have yet to agree on a definition and construct of CEO reputation, often using related constructs such as celebrity, status, and certification as proxies for the CEO's reputation (Graffin, Pfaffar, & Hill, 2012). In a recent review of CEO reputation, the construct is defined as "…a collective judgment of an executive's ability to consistently deliver value over time; something that reduces stakeholders' uncertainty in predicting an executive's future behavior; and an asset that also may have a positive impact on organizational performance" (Graffin et al., 2012). This executive's ability to deliver and to foster the organization's ability to create value is situation specific; thus, the CEO's ability to meet the going-in-mandate is central to the CEO's creation of firm value.

While a number of scholars take a one-dimensional approach to defining CEO or firm reputation, recent work has noted three dimensions of reputation--being known, being known for something, and being known favorably. (For a review of reputation definitions in the recent 30 years and the three dimensions of reputation, see Lange, Lee, & Dai (2011.) Consistent with notable work on reputation including multiple dimensions (e.g., Rindova et al., 2005), this dissertation includes the level of reputation awareness ("being known") and reputation for capabilities ("being known for something" and "being known favorably") to examine the CEO's reputation and the firm's perceived going-in-mandate. Developing valid constructs of reputation presents a challenge. Thus, these measures address criticisms of prior reputation measures including the lack of positive and negative spectrum of reputation (Walker, 2010) and lack of multiple dimensions of reputation (Lange et al., 2011).

A construct of reputation for a capability has recently been theoretically and empirically introduced. This dimension of reputation is expressly intended to address the issue of information asymmetry and adverse selections when stakeholders (i.e., shareholders) are unable directly assess the capability or quality in question (Mishina et al., 2012). The level of reputation awareness is directly proportional to the number of print articles in prominent, high circulation news sources (Deephouse, 2000).The measures for the CEO's reputation (positive and negative) for the capabilities of leadership and effective strategic management and the perceived going-in-mandate for leadership and effective strategic management will be built with a multidimensional construct of reputation (e.g., Deephouse & Carter, 2005; Rindova, Petkova, & Kotha, 2007; Rindova et al., 2005). The operationalization of reputation for the capability of leadership and strategic management, a collective judgment regarding abilities or limitations (Mishina et al., 2012), will use the Janis-Fadner coefficient of imbalance (e.g., Philippe & Durand, 2011) to examine the reputation for the capability of the CEO. Additionally this same operationalization formula is used to calculate the reputation for the capability of the firm, which will serve as a proxy for the perceived going-in-mandate. This measure incorporates the relative number of positive (p) and negative (n) mentions to serve as a proxy for the reputation of the capabilities as presented in the media one year prior to the CEO selection:

$$(p^2 - p.n)/(p + n)^2 \text{ if } p > n;$$
$$0 \text{ if } p = n;$$
$$\text{and } (p.n - n^2)/(p + n)^2 \text{ if } n > p.$$

The going-in-mandate has not been explicitly defined in the literature, as it is not generally disclosed to shareholders. However, the perception of the fit of the CEO's reputation for specific types of capabilities to the needs of the firm is integral to the shareholders assessment of the adverse or favorable selection. Thus, shareholders are influenced by the media attention to firm deficiency prior to the succession event and the CEO's compensation structure. Researchers operationalize the going-in-mandate as a CEO's actions (Gabarro, 1987; Hambrick & Fukutomi, 1991; Zhang, 2011). For example, the outside CEO successor, well known for making major changes, may simply be executing the board's desire for change (Hambrick, 2007). Research has examined a range of outside, successor CEO's actions, including changes in strategic reorientation (strategy, structure and control changes), firm innovativeness (new patent applications), diversification, human resources (staffing changes), and the functional and symbolic leadership of the firm (e.g., Bigley & Wiersema, 2002; Finkelstein et al., 2009; Virany, Tushman, & Romanelli, 1992; Wu, Letivas, & Priem, 2005). Thus, the fit of the CEO's abilities to the going-in-mandate of the hiring firm represents a significant signal to the shareholders about the favorability or adverse selection of the new CEO.

Furthermore, the new CEO's reputation awareness and firm's reputation awareness can serve as a signal of the amount of information available to the shareholders at the time of the CEO selection. Not only are shareholders concerned with issues of adverse selection between the CEO and the BoD, shareholders also are not privy to the confidential information the BoD possesses about the new CEO and the firm's needs. Although shareholders may not have access to direct information about the new CEO, reputation awareness of the CEO signals that the shareholders may have access to some degree of information with which to make an assessment of adverse or favorable CEO selection.

Additionally, the compensation package of the CEO may serve as a signal to shareholders concerning the BoD's reservations regarding CEO adverse selection. For example, prior research has found that the BoD's initial compensation for the CEO serves as a predictor of that CEO's length of tenure; specifically, those with lower initial compensation are more likely to leave the firm, be fired, or resign in the first four years (Allgood et al., 2012). Additionally, the proportion of compensation that is performance dependent is high when high information asymmetry exists between the CEO and the BoD (Eisenhardt, 1989; Harris & Helfat, 1997).

This study contributes to several areas of research. This dissertation expands the work in agency theory on information asymmetry regarding the CEO selection process; specifically, on the information that shareholders may have about the capabilities of the CEO that contribute to the perceptions of adverse or favorable selection. Additional contributions of this study include insight into the market reactions to CEO selection announcements- the reaction to the announcements of those newly-appointed, seemingly-qualified CEOs that have prior CEO experience. This dissertation examines signals that influence the shareholders' perception of adverse selection and contributes to the literature on a reputation's effect on the perception of adverse selection. Additionally, the dissertation develops a construct of CEO reputation and the perceived going-in-mandate, and investigates the effect these constructs and CEO compensation may have in shaping the perception of the adverse selection of the CEO.

This dissertation proceeds as follows. The next section reviews the research on agency theory with an emphasis on information asymmetry associated with adverse selection. The section is followed by a discussion of the CEO selection process with a focus on what is known about the BoD's development of the going-in-mandate, the subsequent CEO selection, and shareholders' reaction to the succession process. Then, there is a review of reputation, specifically what is known and remains unexamined about the firm and CEO reputation. This review is followed by the development of hypotheses for the relationships among the signals that diminish the shareholders' perception of adverse selection and shareholders' reaction to a CEO selection announcement. These hypotheses are followed by a methodology used to test the hypotheses. This methods section includes a description of the sample, the operationalization of variables, and the event study methodology. Finally, I present the results of the empirical analysis, a discussion of the results and practical implications of the results, an outline of the limitations of the study, and an agenda for future research.

AGENCY THEORY

Agency theory suggests that problems can arise when one party (the principal) contracts with another (the agent) to make decisions on behalf of the principal (Fama & Jensen, 1983; Milgrom & Roberts, 1992; Ross, 1973). Due to incomplete information associated with the transaction, a principal incurs costs (e.g., investigating and selecting the agent, monitoring agents, incentive compensation tied to performance, bonding, and residual loss costs) to protect his or her interests from the probability that the agent will behave in a way that is incongruent with the principal's goals (Barney & Hesterly, 1996). The principal strives to minimize these costs, while decreasing information asymmetry and uncertainty (Kesner, Shapiro, & Sharma, 1994). Agency theory can deal with any principal-agent relationship (e.g., doctor-patient, lawyer-client); but, the literature focuses on the relationship between owners and managers, specifically the relationship between a CEO (agent) and the shareholders (principal) (Fama 1980; Jensen & Meckling 1976).

Agency theory is established on three conceptual foundations. First, markets experience inefficiency because of search, information, and bargaining costs. This inefficiency can add to the cost of procuring something within a firm. Thus, enterprises try to avoid these costs through a collection of contracts (Coase, 1937). Second, the modern, western corporation has evolved in such a way that there is a separation of ownership and control; thus, the interest of the principal (shareholders) and agents (managers or CEOs) may diverge. "… [A business enterprise] involves the interrelation of a wide diversity of economic interests, those of the "owners" who supply capital, those of the workers who "create," those of the consumers who give value to the products of enterprise, and above all those of the control who wield power" (Berle & Means, 1932; 310). Third, information asymmetry between a buyer and seller allows high and low quality services to co-exist seemingly at parity in the market and makes the determination between high and low quality services problematic and costly for the buyer (Akerlof, 1970).

In addition to agency theory's conceptual foundations, there are also several human and organizational assumptions that serve as additional grounding for agency theory. Agency theory is also based on the assumptions that principals and agents are boundedly rational, self-interested, opportunistic, and risk-averse. Additionally, this theory is based on the organizational assumptions that include goal conflict among participants, efficiency as the effectiveness criterion, and information asymmetry between principal and agent (Eisenhardt, 1989). Thus, the agents act rationally, contingent on their knowledge to maximize utility by minimizing personal risk through opportunistic and self-serving behavior. Additionally, owners will make decisions that minimize loss from goal incongruence between parties through efficient contracts and cost effective information gathering. These decisions lead to organizational costs associated with investigating and selecting the agent, monitoring the agent, incentive compensation tied to performance, bonding, and residual loss.

One of the ways principals try to manage organizational costs is by appointing a BoD to serve as a fiduciary for the owners. The board is responsible for monitoring the top management team (and certainly the CEO) and advising in strategy formation

(Finkelstein et al., 2009). The board accomplishes this by designing compensation packages that minimize the goal and risk conflict between agent and principal and the potential for opportunism and self-serving behavior of the agent, dismissing poorly performing CEOs, and providing feedback to the top management team for the firm's strategic direction (Fama & Jensen, 1983). The BoD plays an active role in managing problems that may arise from the separation of ownership and control.

Agency theory contends that incomplete information and uncertainty between the principal (shareholder) and the agent (CEO) present two problems, moral hazard and adverse selection. Moral hazard refers to the lack of effort on the part of the agent; that is, the condition under which the principal cannot be sure if the agent has put forth maximum effort toward reaching the principal's goals. Adverse selection is the condition in which the principal cannot ascertain if the agent accurately represents his ability to accomplish his employment duties (Eisenhardt, 1989). Whereas the moral hazard problem in agency theory deals with the information asymmetry between the principals and agents as agents fulfill their duties, the adverse selection problem deals with the information asymmetry prior to hiring the agent (Husted, 2007). There is a temporal difference between the information asymmetry between the BoD and CEO before and after hiring the CEO (Van Oosterhout, Heugens, & Kaptein, 2006). Adverse selection concerns the ability to discern qualitative and relevant differences between CEO candidates, whereas moral hazard's information asymmetry between the BoD and CEO concerns the inability to know motivations and observe a CEO's actions (Sanders & Boivie, 2004).

Agency theory research on moral hazard has specifically focused on the mechanisms by which the principal can minimize goal and risk incongruence and opportunism of the agent with the condition that the principal lacks perfect information about the agent's actions. Jensen and Meckling (1976) observed that although agency problems exist, they can be dealt with through the use of governance mechanisms such as monitoring, incentive compensation, bonding, and the market for corporate control. Thus, principals balance the costs of governance mechanisms and residual loss or "the dollar equivalent of the reduction in welfare experienced by the principal due to this divergence" (Jensen & Meckling, 1976: 81). (For a complete review of the research on the moral hazard problem and the governance mechanisms that serve as solutions, see Dalton, Hitt, Certo, & Dalton, 2007.)

The BoD that monitors the CEO to mitigate the moral hazard problem also selects (hires) the CEO. Thus, the BoD serves a role in the adverse selection problem. The need to hire a CEO may be the result of a failure of the BoD to minimize the moral hazard problem or a failure to provide effective guidance/advice for the strategic direction of the firm (Boeker, 1992). As information during the CEO selection process may be costly or unavailable, the information asymmetry and uncertainty associated with hiring a CEO may make mitigation of the adverse selection problem challenging.

The BoD balances the costs to minimize information asymmetry and the potential costs of adverse selection. The choice of CEO can serve as a highly profitable or costly endeavor to the shareholders. Through the use of variance decomposition, Mackey (2008) re-examined the relationship between the CEO and firm performance, finding that CEOs significantly influence corporate-level performance, accounting for 30 percent of the variance in corporate profitability, but have limited influence on business-level performance, accounting for only 13 percent of variance in business level profitability. A failed CEO can cause significant disruption to the firm (Zhang, 2008) or result in firm failure (Carroll, 1984).

INFORMATION ASYMMETRY AND ADVERSE SELECTION

Research has typically considered adverse selection caused by information asymmetry in labor markets (Coff, 1997), joint ventures, mergers, and acquisitions (Balakrishnan & Koza, 1999; Reuer & Miller, 1997; Shimizu, Hitt, Vaidyanath, & Pisano, 2004); however, information asymmetry and adverse selection have been applied to many market settings (e.g., insurance, banking/lending, consumer product purchasing decisions, IPO decisions) and are included in several theories of market relationships. Still, the cornerstone of adverse selection is information economics, where research on theoretical economics deals with the real world problems of market failure due to incomplete information (Rosser, 2003).

Information economics introduced adverse selection as the lemon problem. Akerlof (1970) presented the problem of adverse selection in numerous contexts; nevertheless, the most commonly used of his examples is the market for used cars. The premise was that market inefficiency, in the form of information asymmetry, existed between the buyer and seller, where the buyer cannot determine the quality of a used car and the seller although possessing more information may be unable or unwilling to convey it. Thus, a seller was more likely to sell those cars that have an intrinsically less value than the market price, and buyers were more likely to purchase a lemon. In this example, there was no signaling or bargaining—buyers and sellers determine whether to be in the market based on the price the market sets (Levin, 2001).

Signals can mitigate information asymmetry between two parties within a transaction—these signals may prevent adverse selection. Although Akerlof (1970) alluded to education and reputation as a proxy for unknown quality, signaling theory[4] suggests that the information can be transmitted between parties to increase information symmetry (Spence, 1973). Thus, a signal communicates unobservable information between two parties. For example, Spence (1973) observed that (potential) employees use educational credentials to signal their abilities. Employers then interpret the validity of these signals and thus the value of the signal. Signaling theory holds that information asymmetry is reduced by sending and interpreting signals (Riley, 1989).

Strategic management theory has identified an assortment of signals that transfer information on quality. For example, reputation may serve as a signal to stakeholders of a firm's underlying quality (Deephouse, 2000). Similarly, a characteristic of a BoD or firm ownership may serve as a signal to shareholders of the legitimacy or value of the firm (Certo, Daily, & Dalton, 2001; Goranova, Alessandri, Brandes, & Dharwadkar, 2007). As such, the frequency of the signal, the signal fit (the extent to which the signal or public information is related to the unobservable or private information), and the perceived honesty of the signaler influence how the receiving party perceives the signal (Connelly et al., 2011).

Research in finance demonstrates that information asymmetry within a firm's transactions can significantly affect a firm's market value. For example, in US public firms that are acquired for more than one millions dollars, abnormal returns of an acquirer have been found to be negatively related to the information asymmetry of a

4 Some argue that in addition to signaling theory the information asymmetry associated with adverse selection can be decreased by screening, a process of self-selection that redistributes the risk associated with information asymmetry (Stiglitz, 1975; Rothschild & Stiglitz, 1976); others however, argue that there is not meaningful distinction between signaling and screening (Spence, 1976).

transaction as proxied by ownership, analyst information, and cash versus equity acquisitions (Moeller, Schlingemann, & Stulz, 2007). Additionally, the choice of equity, cash, or debt to finance an acquisition serves as a signal to shareholders and influences the abnormal returns of the acquiring firm (Houston & Ryngaert, 1997; Travlos, 1987). This literature also presents a two-sided information asymmetry framework, where both parties in a transaction have private information about their own value (Gao, 2011; Rhodes-Kropf & Viswanathan, 2004), for which signals between parties can decrease the perceptions of adverse selection by the shareholders observing the transaction.

Signaling theory has gained momentum in the literature. (For a complete review of signaling theory see Connelly et al., 2011.) Signaling theory has emerged as an important way to explain how non-market information influences a firm's stakeholders (e.g., consumers, shareholders, investment banks, potential acquirers, BoD, labor markets). Financial information has become less relevant and non-financial information has become more relevant in determining equity pricing (Certo et. al., 2001). Thus, signals have expanded from relevant financial statement indicators to include reputation, press releases, and association memberships (Carter, 2006; Deephouse, 2000).

Examples of information asymmetry exist within work on M&As (Buchholtz, Lubatkin, & O'Neill, 1999; Coff, 2002), advertising and branding (Chung & Kalnis, 2001) and the decision to diversify (Nayyar, 1993). Additionally, signaling has been used to deal with information asymmetry within corporate governance. Specifically, these signals have focused on the characteristics of the top management teams (TMT) and BoD and the ownership concentration of insiders. These signals show shareholders the quality and legitimacy of management, the accuracy of monitoring, and the minimization of goal incongruence (Certo et al., 2001; Goranova et al., 2007; Filatochev & Bishop, 2002; Zhang & Wiersema, 2009).

Research that deals with information asymmetry and adverse selection has focused on the outcomes of a transaction (potential for adverse selection related residual loss) or the influences that private information (i.e., signals) has on the outcomes of a transaction, but failed to directly test information asymmetry, as it was difficult to accurately measure the extent of information asymmetry (Chemmanur, Paeglis, & Simonyan, 2009).

ADVERSE SELECTION

Determining if a CEO is an adverse selection is complex (Shen & Cannella, 2002a). In a traditional labor market, employment suitability is evaluated by how well the person performs in his or her job; however, determining the successful execution of the CEO position is difficult to judge because the CEO's decisions are only one of many factors that influence firm performance. Research has found that the CEO effect on firm performance explains between 29.2 percent and 12.7 percent of ROA performance (Mackey, 2008). Although there is a significant percentage of performance variance explained by the CEO, firm performance alone cannot explain adverse selection. However, findings have shown that a deviation from expected performance by a firm is a signal of adverse selection (Shen & Cannella, 2002b; Weintrop, 1991).

A BoD dismisses a CEO based on past performance, observed ability and behavior, and if the CEO has minimal potential to create value in the future (Zhang, 2008). Thus, although a BoD hires a CEO, the board may occasionally dismiss a CEO quickly if it determines that s/he is unable to fulfill future duties of the office. The CEO's ability to exert power and the CEO's fit within the organization may decrease the BoD's perception of adverse selection (Wiersema & Zhang, 2011). Ocasio (1994) reported that low performance and low CEO power over the board increases the likelihood of CEO dismissal. These findings corroborate the proposition that a CEO's adverse selection may be due to political and power struggles in addition to the performance of his or her duties (Fredrickson, Hambrick, & Baumrin, 1988). Additionally, Shen and Cannella (2002a) found that the likelihood of the BoD dismissing the CEO is further increased by the outside status of the CEO, the prior CEO's short tenure, and lack of CEO ownership in the firm. Central to the success of the CEO selection process is the fit of the CEO to the needs of the firm. CEOs that are not well suited for the position are often replaced; however, replacement has a positive effect on stock price performance only if the replacement appears to fit the organization - the CEO has industry experience, outsider status and appropriate functional background for the needs of the firm (Chen & Hambrick, 2012).

Adverse selection of a CEO has been measured, in addition to negative firm performance and the dismissal of the CEO, as the market reaction to the CEO appointment announcement. Zhang (2008) found that the level of information asymmetry at the time of succession, influenced by outsider status, the presence of a dedicated nominating committee, and length of the BoD's succession planning time, increases the probability that the CEO will be dismissed within the first three years. Adverse selection and perceived adverse selection are different. CEO succession may signal to external stakeholders a BoD's desire to enact dramatic change in the organization (Suchman, 1995); as a result, shareholders may perceive an adverse selection in times of positive financial performance, regardless of the quality of the successor, because shareholders desire to maintain the status quo. In times of good performance, CEO succession may signal to shareholders an undesired change from the status quo (Friedman & Singh, 1989).

Wiersema and Zhang (2011) proposed that third parties (e.g., investment analysts) play a role in the perception of adverse selection by providing an independent assessment of CEOs' past performance and their ability to influence firm performance. Recent finance research specifically found that price sensitive information, such as media information on acquisitions, divestitures, or revenue projections that could influence firm strategy, would decrease the perception of information asymmetry surrounding significant firm events affecting the market response of the stockholders (Chan, 2003; Fang & Peress, 2009). Similar research findings established a relationship between the media's announcement of a CEO death and the decline in market value of a stock (Worrell, Davidson, Chandy, & Garrison, 1986). A successful, CEO must have capabilities that the firm needs (Zajack, 1990). Within the succession process, it can be difficult to determine if the CEO lacks those competencies and is therefore an adverse selection.

Although compensation of the CEO can serve as a motivator of the CEO for goal and risk congruence between the CEO and firm (for extensive review on CEO compensation, see Devers, Cannella, Reilly, & Yoder, 2007), CEO compensation structure can also serve as a signal of the quality of the CEO and the information asymmetry between CEO and hiring firm. Specifically, Harris and Helfat (1997) noted that hiring an outside successor is a balance between a unique CEO skill set and the uncertainty of the quality of the CEO. Thus, although the outside CEO successor may demand a premium as a symbol of value and to offset risk of taking a new job, if the firm has less information about the CEO than it desires, the firm may be unwilling to pay non-performance contingent compensation upfront. With less knowledge about the true nature of the CEO, the BoD is less likely to compensate a CEO with an outcome-based rather than behavior-based contract (Eisenhardt, 1989).

Additionally, the corporate finance literature uses job match theory, similar to the concept of CEO fit, to theorize favorable or adverse selection of the CEO. Within this research, Allgood and colleagues (2012) found that CEOs with higher initial compensation are also the CEOs most likely to have tenure greater than 4 years, whereas those with lower initial compensation had shorter tenures. The conclusion drawn by this research is that the BoD compensates the CEO based on information that the BoD has about the CEO-candidate prior to hiring the CEO, supplying higher compensating to the CEO with lower likelihood of adverse selection (Allgood et al., 2012).

CEO SELECTION PROCESS

From an economics perspective, the selection of a CEO is a basic economic transaction, where the supply side of the market consists of CEO candidates and the demand side of the market consists of firms seeking a CEO (Wiersema, 1992). However, given the information asymmetry between parties and the effect that the choice of the CEO can have on firm strategy and value, this is far from a simple transaction. Although there are a number of studies that consider factors influencing the CEO selection process (See Finkelstein et al., 2009 for a complete review), Zhang (2008) notes that the BoD, the characteristics of the new CEO, and the context of the CEO succession process (whether the CEO was fired, the time frame to select the new CEO, and the prior CEOs influence on selection) affect the information asymmetry at the time of succession and the likelihood of an adverse selection.

Despite the importance of the CEO succession process, little theory has been developed to explain the board's role in this process (Vancil, 1987; Zhang & Rajagopalan, 2010). What is known about the succession process is largely anecdotal. The BoD is thought to have the capabilities necessary to determine the firm's present and future leadership needs (Henderson, Miller, & Hambrick, 2006); however, fewer than 50 percent of boards have established succession plans (Miles & Bennett, 2009). The BoD is charged with hiring and monitoring a CEO. Prior to seeking a CEO, the board determines the criteria by which the CEO will be selected. Many of the criteria are based on a "going in mandate," a mandate based on firm needs, determined by the BoD to be addressed by the incoming CEO, often derived from the organization's performance and prospects (Hambrick & Fukutomi, 1991). As a result, in the early stages of tenure, CEOs are focused on the mandate for which they were selected (Souder, Simek, & Johnson, 2012). The board begins this selection process by determining the conditions the firm will face in the future and thus the needs of the firm (Vancil, 1987).

Yet, the going in mandate has never been operationalized; the mandate is a latent unobserved construct capturing the board's desire for change to be executed by a CEO[5] (Quigley & Hambrick, 2012). Quantitative data do not directly convey the BoD's objectives for the new CEO; although researchers draw the conclusions that the BoD develops a specific mandate for satisfying the firm's needs (Ballinger & Marcel, 2010; Vancil, 1987). The new, external CEOs tend to make strategic changes as directed by the going-in-mandate set by the board rather than the CEO's inclination for immediate change (Hambrick & Fukutomi, 1991). Thus, as the directives presented by the BoD to a CEO are not disclosed, researchers construct a going-in-mandate largely based on the strategic changes that the CEO undertakes.

CEO succession results in change within the firm. Specifically, these changes may result in a more diverse firm product line (Boeker, 1997; Wiersema & Bantel, 1992), increases in competitive aggression (Barker, Patterson, & Mueller, 2001) and structural changes to the firm or concentration of management power (Miller, 1993). Zhang and Rajagopalan (2010) found the succession event is positively related to

5 There may be situations in which the BoD's desires the continuity of leadership's actions and direction despite a newly appointed CEO. This is an issue not addressed to my knowledge in the literature or research on CEO selection or succession. Thank you to a committee member who pointed out this under addressed issue.

strategic change. During periods of extreme firm decline in net income or market value, the CEO may lead the firm through significant changes in the strategic actions, as well as serve as a symbol of impending change to the employees and shareholders of the firm (Trahms, Ndofor, & Sirmon, 2013).

The BoD is responsible for identifying the critical contingencies to determine a going-in mandate and then matching the characteristics of the CEO to these needs. The criteria by which the CEO is chosen remain private information (Lorsch & Khurana, 1999; Shen & Cannella, 2003). The lack of transparency is an issue for shareholders, especially given the increased criticism of the BoD regarding CEO selection and the enhanced rate of involuntary succession from 13 percent in the 1980 to more than 30 percent in 2000, with a 5.3percent increase in the CEO dismissal rate from 2012 to 2013 (Aguilar, Schloetzer & Tonello, 2013; Finkelstein et al., 2009; Wiersema, 2002).

Shen and Cannella (2002a) noted that the CEO is chosen for leadership ability and ability to successfully implement a going-in-mandate. Most research on the information asymmetry in the selection of the CEO has focused on (1) the firm insider or outsider distinction, (2) the industry insider and outsider distinction, and (3) the prior experience of the successor. These upper echelon characteristics serve as a proxy for ability and motivation (Hambrick & Mason, 1984). Although the following discussions review the choice of the successor by characteristics, it is important to acknowledge that many researchers suggest the use of psychometric or qualitative approaches, rather than upper echelon characteristics, for determining the ability and motivations of successors (e.g., Datta & Rajagopalan, 1998; Finkelstein et al., 2009; Hambrick et al., 1993; Kenser

& Sebora, 1994; Pitcher et al., 2000). The studies on the relationship between these proxy-based successor characteristics and firm performance have met with mixed results and much criticism (Finkelstein et al., 2009; Furtado & Karan, 1990).

Although the relationship between the choice of origin (insider or outside distinction) and firm actions and performance has engendered mixed results, this distinction remains important for succession researchers for it represents "a variation of a broader issue of continuity versus change" (Finkelstein et al., 2009: 194). While inside CEOs have firm-specific knowledge and skills for experiences within the firm, outside successors have novel skills that may not be present within the firm (Harris & Helfat, 1997). A successor from outside the firm may result in changes to the status quo within the firm (Zajac & Westphal, 1996). Thus, the general expectation is that outside successors specifically receive a mandate to initiate changes to the firm's mission, objectives, and strategy (Goodstein & Boeker, 1991; Wiersema, 1992). Therefore, the choice between an inside and outside successor represents the balance between a need for change and the costs of information asymmetry. There is less information asymmetry between a new, inside CEO and the BoD than between a new, outside CEO and the BoD, because of the joint work experience between the insider and the BoD prior to the CEO selection (Zajac, 1990). Disruptive change and high information asymmetry are equated with the outsider successor (Helfat & Baily, 2005) and the status quo and less information asymmetry are equated with the inside successor.

Additionally, the distinction between outside successor with or without industry experience also has been studied. Similar to tenure within the firm, tenure within the industry alludes to maintenance of industry norms within a firm (Geletkanycz & Hambrick 1997; McDonald & Westphal, 2003). Firms seeking a strategic change that deviates from industry practices are less likely to choose a CEO with long industry tenure (Chen & Hambrick, 2012), for an industry outsider represents the prospect of new knowledge and expertise (Zhang & Rajagopalan, 2004).

The CEO position is significantly different from all other TMT positions (Kesner & Sebora, 1994). The CEO’s job is complex, requiring a CEO to integrate large and often highly-diverse quantities of information and communicate with and lead many functionally diverse executives (Mintzberg, 1973; Zhang & Rajagopalan, 2004). If a new successor has never served as a CEO, shareholders may doubt the ability of the CEO to develop a strategic vision for the firm, manage complex decision-making processes, and communicate effectively with both employees and external stakeholders (Graffin et al., 2011).

Finally, the context of the CEO succession process (timeframe of succession and prior successor’s reason for leaving) affects the information asymmetry at the time of succession and thus the likelihood of an adverse selection. A successful selection process takes time. Choosing a suitable CEO successor requires the BoD to either groom internal candidates or conduct an exhaustive search for external candidates (Zhang & Rajagopalan, 2004). The normal succession process and the necessary due diligence to select a suitable CEO successor may be circumvented when the prior CEO either leaves abruptly or is dismissed. CEOs do not generally voluntarily depart from their CEO positions (Fee & Hadlock, 2003); however, a CEO is more likely to leave the position abruptly as a firm approaches bankruptcy (Cannella, Fraser, Lee, & Semadeni, 2002). Additionally, Finklestein, Hambrick and Cannella (2009) present a crisis succession process for which the CEO is replaced suddenly due to CEO dismissal or death. Although little research has examined the choice of successor in the crisis succession event, research has shown that outside successors are more likely to be chosen in bankrupt or near bankrupt firms (Davidson, Worrell, & Dutia, 1993).

In a successful succession process, first the BoD determines the needs the firm will face immediately and in the foreseeable future, then the BoD hires a CEO that best fits these firm needs (Chen & Hambrick, 2012; Finkelstein et al., 2009), and finally the BoD communicates this fit to the shareholders (Hillman, Cannella, & Paetzold, 2000). Criticisms exist as to whether the BoD has the required skills to successfully manage the selection process (Wiersema, 2002; Zhang, 2008). Given the lack of disclosure by the BoD during the selection process, shareholders may be unlikely to effectively determine the difference between a favorable or adverse selection of a CEO, even if the BoD can successfully assess the firm's needs and the CEO ability to meet the firm needs.

As noted, the CEO selection process lacks transparency for the shareholders because the BoD often does not disclose succession information, even when formally requested by shareholders (Zhang & Rajagopalan, 2010). Shareholders not only often do not know the criteria by which the CEO is chosen, but also are suspicious about the ability and motivations of the BoD to effectively manage the succession process. Boards have often been criticized for not having the necessary skills and assurance to guide the CEO succession process (Gabarro, 1987; Khurana, 2002b; Wiersema, 2002; Zhang, 2008). For example, BoDs are criticized for not having the experience necessary to choose a CEO, the time to effectively select a CEO given the lack of succession planning by 50 percent of BoDs, and the motivation to select a CEO without allowing personal bias influence the choice (Wiersema, 2002; Zhang, 2008). Given the high and increasing rate of CEO dismissal in the first three years of tenure, from 13 to 30 percent from 1980 to 2000 (Wiersema, 2002), this worry appears to be well founded.

Shareholder reactions to succession events have had mixed results. However, research has noted that shareholder reaction to a CEO succession event is influenced by observable characteristics of the firm, the outgoing CEO, and the incoming CEO (Finkelstein et al., 2009; Kesner & Sebora, 1994). While some research has found that the market responds positively to the announcement of a successor (Davidson et al., 1990), other research has found no abnormal returns for either insider or outsider successors (Furtado & Karan, 1990). Additionally, the context of the succession may matter to shareholders. Davidson, Worrell, and Dutia (1993) found that although shareholders react negatively to bankruptcy, they react positively to succession both before and after bankruptcy. Additionally, these researchers found outside successions are more positively received than insider successions in this situation.

However, certain successor characteristics have been found to have an effect on the firm’s abnormal returns. Heir apparent inside successors (Shen & Cannella, 2003), and outside successors (Harris et al., 1994; Worrell, Davidson, & Glascock, 1993) have been found to have a positive effect on the stock market’s reaction. Conversely, research has also found that shareholders react positively to insider successor (Worrell &

Davidson, 1987) and negatively to outside successors (Warner, Watt, & Wruck, 1988; Finkelstein et al., 2009).

Research on the CEO successor effect on the firm's abnormal returns has expanded to examine the perceived quality of the CEO. For example, a positive association was found between abnormal returns and CEO certification (Zhang & Wiersema, 2009). In contrast, firms that appointed outside CEOs without prior experience as a CEO created strategic noise (an anticipatory and preemptive form of impression management, where firms simultaneously release confounding information) to hide the appearance of an adverse selection (Graffin et al., 2011). Thus, firms acknowledge the appearance of qualifications of the CEO as a factor in the market reaction to the CEO.

Given the mixed market reaction to outside successors (Harris et al., 1994; Warner et al., 1988), it is difficult to predict exactly how shareholders will react to a CEO appointment. A strong negative market reaction to the CEO appointment damages the CEO and the BoD. Negative market reactions may harm the incoming CEO's legitimacy and may contribute to the high dismissal rate of new CEOs (Ocasio, 1994). A strong negative market reaction results in significant costs to the BoD's compensation and reputation (Sahlman, 1990). Also, BoD members that suffered significant negative market events were more likely to lose their board appointment within two years (Arthaud-Day, Certo, Dalton, & Dalton, 2006). CEO succession is one of the most important duties of the BoD - the board is often blamed for poor performance of the CEO, but unable to take credit for success (Graffin et al., 2011).

REPUTATION

In the absence of perfect information, reputation can serve as a signal of quality thereby reducing uncertainty for observers (Rindova & Fombrun, 1999). Reputation is commonplace in business interactions; however, empirically capturing reputation in research remains challenging.

Reputation is defined as a perception about a combination of past actions and future expectations (Fombrun, 1996). Specifically, reputation has been identified as having three components, b*eing known* (generalized awareness), *being known for something* (perceived predictability of behavior) and *generalized favorability* (perceptions of overall quality) (Lange et al., 2001).[6]

Organizational reputation has been extensively measured employing many proxies and measures; yet, the CEO reputation research is in its formative stage (Graffin et al., 2012). CEO reputation has examined the awareness of the CEO's effect on compensation and the CEO's celebrity effect on compensation and organizational performance.

Determining the quality of a CEO is difficult, because the connection between CEO action and firm performance is confounded (Mackey, 2008). Directors cannot definitively know which CEO qualities lead to increases in firm performance (Khurana, 2002). In the absence of a direct, observable relationship between the CEO's decisions and firm performance, the perception of the CEO's influence on firm actions and

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6 Rindova, Williamson, Petkova and Sever (2005) identify two dimensions of reputation, the perceived quality of attributes and the prominence of the individual or firm.

successful outcomes impact future expectations of the CEO. When the extent of the CEO's ability is not discernible, reputation serves as a proxy for ability (Milbourn, 2003). Reputation may be a particularly important signal of the quality and fit of human capital for the assignment in hiring professional services (Hitt, Bierman, Shimizu, & Kochhar, 2001).

The concept of CEO reputation has limited empirical work associated with it. Constructs measuring CEO reputation have focused on a subset of CEOs who have high positive reputations (e.g., winning awards for their past performance), CEO characteristics (e.g., tenure, insider or outsider status), firm performance, or the number of business related articles that mention the CEO for a five-year period. Early work on CEO reputation found an association between higher reputation CEOs and less market sensitive incentive compensations packages, whereas lower reputation CEOs receive compensation packages that are more market sensitive to firm performance (Milbourn, 2003). These findings have several limitations. First, the measure of reputation is based on multiple factors, including CEOs' characteristics (e.g., tenure, insider or outsider status) that do not refer to the actions of the CEO, firm performance which may not directly reflect CEO action, and print media mentions of the CEO that may refer more to the CEO's publicity than reputation.

Later studies on reputation represent CEOs' reputations as a specific subset of actions or behaviors. For example, management may have a reputation for transparent reporting in financial statements. This positive reputation discourages shareholders from seeking independent information about financial disclosures, even when malfeasance would financially benefit management (Hodge, Hopkins, & Pratt, 2006). Graffin and Ward (2010) found that third parties, such as stakeholders involved in the ranking of certification processes, signal the quality of an CEO's attributes, both when the association between actions and performance is loosely coupled and when the performance of the CEO is positive and visible, but the performance is not easily comparable to peers. Additionally, Graffin and Ward (2010) found that in both situations, the overall reputation of the CEO is increased by the positive signals concerning ability and comparability.

Research has also examined the celebrity reputation for an elite set of CEOs. This research has found that CEOs who win certification awards see an increase in their compensation; however, celebrity CEOs whose firms experience a decline in ROE, see compensation decline at a greater rate than the non-celebrity CEOs (Wade, Porac, Pollock, & Graffin, 2006). Additionally, the top management teams of the celebrity CEOs obtained higher compensation and are more likely to succeed the CEO when they step down (Graffin, Wade, Porac, & McNamee, 2008).

Research examining the association between celebrity CEO and firm performance has produced mixed results. CEO celebrity was initially introduced not as a reputation measure, but to explain the effect of publicity on CEO behavior- particularly for those CEOs who stand out for strategic actions that appear to be directly related to firm performance increases (Hayward, Rindova, & Pollock, 2004). Hayward and colleagues (2004) theorized that publicity has an effect on hubris and over confidence and subsequently on CEOs' actions. Some research has noted that CEO celebrity certification is positively associated with financial reporting quality, short- and long-term market performance, and accounting performance (Koh, 2007). While research has found that firms in which CEOs gain celebrity status initially had a positive effect on abnormal stock returns, long term these firms had negative performance (Wade et al., 2006). Additionally, award winning CEOs were more likely to engage in earnings management and spend more time on activities outside the firm than non-celebrity CEOs (Malemendier & Tate, 2009).

Organizational reputation has been more extensively examined (for reviews, see Lange et al., 2011; Rhee & Valdez, 2009). Although there remains controversy concerning the exact definition of the construct (Lange et al., 2011), most studies refer to organizational reputation as the collective judgment of the consistent quality of activities and outputs over time (Rindova et al., 2005). Organizational reputation is important to stakeholders, because it reduces uncertainty (Benjamin & Polodny, 1999). Organizational reputation is developed through marketing campaigns (Fombrun, 2001), high profile alliances (Rindova et al., 2005), and third party coverage, such as *Fortune* magazine's survey based rankings and media exposure (Deephouse, 2000; Rindova et al., 2005). However, reputation has numerous dimensions. These dimensions are being known, being known for something, and generalized favorability (Lange et al., 2011). Operationalizing organizational reputation remains a struggle, as business journals have even been inconsistent in measuring similar samples, such as business school and MBA program reputations (Rindova, Williamson, & Petkova, 2010).

The organizational reputation dimension of being known is the extent to which the organization receives recognition within a field (Rindova et al., 2005). Barnett, Jermier, and Lafferty (2006) described this dimension as observer or stakeholder awareness of the organization without judgment. Shamsie (2003: 199) defined this particular dimension of reputation as “the level of awareness that the firm has been able to develop for itself.” However, this awareness or prominence communicates nothing about the characteristics of the reputation. As such, many researchers contend that awareness may simply be an antecedent to reputation (Brooks, Highhouse, Russell, & Moh, 2003; Turban, 2001). For without awareness of a firm, how can observers determine the quality and characteristics of the firm?

This component of being known has recently been measured as the level and persistence of a firm’s market share (Shamsie, 2003), organizations selected for use in firm ratings for news magazines (Rindova et al., 2005), and content analysis that counts the extent of coverage (Rindova et al., 2007). Research associating reputation (e.g., awareness or prominence), as measured by America’s most admired firms in *Fortune* magazine, with positive financial performance has been criticized for causality and measurement issues. For when firms face uncertainty, good financial performance results in increases in reputation which allows for a number of positive firm attributes (e.g., charging a premium for product, access to cheaper capital) that lead to competitive advantages and above-average performance (Roberts & Dowling, 2002). Those respondents of the America’s most admired firm survey may simply reference the previous financial performance and not report a true observation of reputation (Capraro & Srivastava, 1997).

Recent research has re-envisioned the construct of reputation, classifying the ‘being known’ dimension of reputation as prominence rather than reputation (Mishina, Dykes, Block, & Pollock, 2010). Specifically, this research noted that prominence amplifies the perception and awareness of positive and negative characteristics of the firm by an external audience (Brooks et al., 2006). Thus, although the awareness of the firm is important for the formation of the reputation, it may not be considered reputation, per se, but rather reputation awareness.

Firms’ actions and capabilities are not readily available as first-hand information for the shareholders (Rindova et al., 2005). The “being known for something” dimension of reputation reduces the information asymmetry of the observer by allowing the observer to base predictions of future, desired behaviors on perceptions of past actions and outcomes (Deutsch & Ross, 2003). Other authors have noted that this component of reputation focuses on the perceived quality of a firm relative to a group of peer firms (Washington & Zajac, 2005; Bergh, Ketchen, Boyd, & Bergh, 2010; Jensen & Roy, 2008).

This component has been operationalized through the use of third party ratings (Benjamin & Podolny, 1999; Pfarrer, Pollock, & Rindova, 2010; Rhee & Valdez, 2009) or media visibility (Jensen & Roy, 2008). Recent research found that high reputation firms are associated with above industry average profitability over time (Roberts & Dowling, 2002), setting higher prices (Benjamin &Podolny, 1999), and auditor selection

(Jensen & Roy, 2008) and are less likely than lower reputation firms to announce earnings surprises (Pfarrer et al., 2010).

Lange et al.'s (2011) review of organizational reputation notes that generalized favorability is based on Fombrun's (1996: 72) definition of reputation as "a perceptual representation of a company's past actions and future prospects that describes the firm's overall appeal to its key constituents when compared to other leading rivals." Thus, generalized favorability differs from being known for something in that it is the aggregate of attributes based on the observer's expectations and frame of reference (Fischer & Reuber, 2007). Generalized favorability is operationalized as media favorability (Deephouse, 2000), magazine or media rankings of best companies (Turban & Cable, 2003), or business school rankings (Boyd et al., 2010). Although most studies simply measure the extent of positive reputation, some studies measure the positive and negative tenor of reputation in the media (Deephouse & Carter, 2005). Similar to being known for something, generalized favorability has been found to influence pricing premiums (Boyd et al., 2010) and return on assets (Deephouse, 2000), as well as acquisition of higher quality human capital (Turban & Cable, 2003).

A theoretical extension of reputation has noted that the being known for something dimension is composed of both reputation for a capability of reputations and the character reputations. A reputation for a capability reputation is an external observer's perception of what can be done (abilities) by a firm or individual, whereas a character reputation is an external observer's perception of what would be done (intentions) by a firm or individual (Mishina et al., 2012). This extension of the reputation construct's dimensions specifically serves as a signal to reduce information asymmetry present in agency theory problems. Reputation for a capability reputation minimizes the uncertainty which stems from the inability to directly observe quality or capability (adverse selection) and character reputation diminishes a similar information asymmetry associated with the uncertainty surrounding the intensions of a firm or individual (moral hazard) (Mishina et al., 2012). Thus, the expanded dimensions of reputation for a capability reputation can influence the perception of adverse selection by reducing uncertainty surrounding the capabilities. Recent research has examined how character reputation, the willingness of a firm to conform to social norms concerning environmental disclosure, influences the overall reputation of the firm (Philippe & Durand, 2011). However, the reputation for a capability construct has yet to be used in empirical research. The development of the operationalization of the character reputation measure, through the use of the Janis-Fadner coefficient of imbalance, allows for the development of reputation for the capability of leadership and strategic management measures that have construct validity and the empirical investigation of adverse selection.

THEORY DEVELOPMENT AND HYPOTHESES

The CEO selection process

Agency theory suggests that problems can arise when shareholders contract with the CEO to make decisions on their behalf (Fama & Jensen, 1983; Milgrom & Roberts, 1992; Ross, 1973). Specifically, the process of CEO selection deals with the management of problems associated with uncertainty and information asymmetry within agency theory. The CEO selection process is filled with uncertainty for the shareholders due to the lack of information transparency about the process. One of the ways principals try to manage organizational costs is by appointing a BoD to serve as a fiduciary for the owners. Agency theory contends that incomplete information and uncertainty between the shareholder and the CEO present the problem of adverse selection; however, the adverse selection problem that deals with the information asymmetry (Husted, 2007) may still exists with a fiduciary in charge of the CEO selection process. Under the best circumstances, the BoD's ability to discern qualitative and relevant differences between CEO candidates (Sanders & Boivie, 2004) and thus decrease the risk of adverse selection may be challenging.

The BoD is charged with hiring a CEO. In a successful selection process, the BoD will determine the firm's needs, known as the going-in-mandate. Then the BoD will hire a CEO that best fits these firm needs (Finkelstein et al., 2009; Chen & Hambrick, 2012). Finally, the BoD will communicate this fit to the shareholders through the CEO appointment announcement (Graffin et al., 2011; Waine, 2002). However, criticisms exist that BoDs do not often effectively management this process. Thus, in addition to the uncertainty and information asymmetry of the CEO qualifications, there are concerns as to whether the BoD has the required skills to successfully manage the selection process (Wiersema, 2002; Zhang, 2008). A failure of the BoD to minimize the moral hazard problem of agency theory or a failure to provide effective guidance or advice for the strategic direction of the firm may be the reason for the need for the new CEO (Boeker, 1992). BoDs have also been criticized for not having the experience necessary to choose a CEO, the time to effectively select a CEO given the lack of succession planning by 50 percent of BoDs, and the motivation to select a CEO without allowing personal bias influencing the choice (Wiersema, 2002; Zhang, 2008).

Although communication to the owners is a primary job of the BoD (Hillman et al., 2000), shareholders lack the salient details concerning many BoD decisions, including the CEO selection process. Thus, in addition to the interpretation of the existing information asymmetry between the BoD and new CEO, an additional information asymmetry exists between the shareholders and the firm. Shareholders in recent years have used proxy statements to request more information about the CEO selection process. A recent SEC staff bulletin allows for the BoD to dismiss requests for information from shareholders. Anecdotal information about the BoDs' reactions to this ruling suggests that the shareholders may still not receive information about this CEO selection process, as firms often claim the need for confidentiality about the process when responding to requests for information (Zhang & Rajagopalan, 2010).

In addition to these very valid concerns of the shareholders, regarding the CEO selection process, are the shareholders' perceptions of the CEO selection process. It is noted that given the lack of transparency of the BoD during this process to the shareholders, their perceptions of effectiveness may differ from the actual effectiveness of board actions (Bednar, 2012). Thus, even if a board has chosen a suitable successor, because the BoD's decision-making remains private—that is, asymmetrical, shareholders may not respond positively to the announcement of the CEO appointment (Graffin et al., 2011).

Studies on the CEO selection process have focused on the characteristics of the CEO that are transparent for the BoD to disclose, such as the origin (inside or outside) of the CEO. This distinction of the new CEO selection represents "a variation of a broader issue of continuity versus change" (Finkelstein et al., 2009: 194). While inside CEOs have firm-specific knowledge and skills, outside successors may have novel skills that are not present within the firm (Harris & Helfat, 1997). A successor from outside the firm is associated with an expectation of change (Zajac & Westphal, 1996). That is, the general expectation is that outside successors specifically receive a going-in-mandate to initiate changes to the mission, objectives, and strategy of the firm (Goodstein & Boeker, 1991; Wiersema, 1992). Thus, as scholars have demonstrated, an inside and outside CEO successor represents two distinct levels of information asymmetry and also two different expectations associated with the going-in-mandate (Zajac, 1990; Zhang, 2008). The BoD has less information about the outside successor than the inside successor; however, an outside successor, with prior experience as a CEO brings a unique set of skills and knowledge to the position of CEO. In this setting, adverse selection is a possibility, as higher levels of information asymmetry increases the likelihood of adverse selection. Nevertheless, the outside successors may have a significant amount of media attention if they also have prior experience as a CEO. Thus, the study of an outside CEO successor with prior CEO experience presents a unique opportunity to investigate the CEO reputation's effect on the shareholders' perception of adverse selection.

Perceptions of CEO adverse selection

Scholars have increasingly recognized the importance of media with respect to shareholders' perceptions of adverse selection of a CEO. Although consensus exists that shareholders react to the CEO succession decision, there is little, if any, empirical or theoretical evidence indicating how shareholders react to the successor choice (Graffin et al., 2011). A positive or negative reaction of shareholders to the succession decision can substantially affect both the CEO and the firm's market value and reputation. A positive reaction to the succession event signals legitimacy of the new CEO; in turn, CEO legitimacy may reduce the uncertainty of the new CEO's tenure (Khurana, 2002b) and may have a significant effect on the positive assessment of the firm by shareholders (Cohen & Dean, 2005).

Research has emphasized the dismissal of a CEO as a sign of adverse selection or the lack of suitability of the executive for the position of CEO; however, research has yet to specifically address the information asymmetry that leads to adverse selection and shareholders' perceptions of the lack of suitability of the CEO for the job (Zhang, 2011). Seemingly qualified CEOs, such as outside successors with previous CEO experience, are assumed to affect the market positively (Finkelstein et al., 2009; Zhang, 2011).

However, firms that appoint new CEOs without previous industry or CEO experience may try to hide a negative market reaction to the appointment through simultaneously releasing confounding information about other significant events (Graffin et al., 2011).[7] Only recently has research begun to address the quality of the fit of the newly appointed CEO's qualifications to the firm's needs (Chen & Hambrick, 2012) and research has yet to examine how the perceptions of fit appears to affect the perceptions of adverse selection.

The CEO selection literature has focused on the available characteristics of the CEO (e.g., outsider, prior experience, age, education, etc.) as a signal of the CEO's suitability for the job (Finkelstein et al., 2009). However, the research proxies available provide very limited information about shareholders' knowledge of CEO quality. Most demographic characteristics of the CEO examined in CEO succession research have failed to capture the quality of skills and experience necessary for evaluating the potential effectiveness of a CEO (Pitcher et al., 2000). Capturing the quality and experience of the CEO is challenging with the use of demographic proxies; however, fine-grained measures may allow for more accurate measures of the CEO's future effectiveness (Datta & Rajagopalan, 1998; Kesner & Sebora, 1994). For example, the use of reputation provides additional information about the potential CEO's ability in addition to that which is available from demographic information about the CEO (Graffin et al., 2012).

7 Although Graffin et al. (2011) does not empirically examine a underlying reason for releasing confounding information, a committee member points out that this confounding data release could be designed to hide the negative reaction of stakeholders or hide the negative market reaction of the appointment.

There are numerous signals available to shareholders that serve to reduce information asymmetry and uncertainty surrounding the CEO selection for the shareholders. However, recent literature on reputation (Mishina et al., 2012) and compensation (Allgood et al., 2012) present a unique opportunity to expand what is known about the agency theory problem of adverse selection. Scholars focusing on reputation have introduced the concept of reputation for a capability to allow researchers to better understand shareholders' perception of the adverse selection problem (Mishina et al., 2012).The perception of adverse selection deals with not only the quality of the CEO, but also the fit of the CEO to the firm's needs. The concept of reputation for a capability can be used to reflect shareholders' perceptions of the CEO successor's abilities or of the dimensions of the going-in-mandate (firm needs from a CEO successor). These two concepts together may reflect the fit of the CEO to the firm and therefore the shareholders' perception of adverse selection. Shareholders' perception of adverse selection is based on the media attention of the new CEO and the hiring firm's needs. Moreover, the newly appointed CEO's compensation package, traditionally associated in agency theory as a mechanism to mitigate the problem of moral hazard, has been found to signal the BoD's assessment of information asymmetry between the BoD and CEO successor (Allgood et al., 2012). Shareholders make a determination on the adverse selection of the CEO by considering the reputations of the CEO, a perception of the going-in-mandate, and the signal sent by the compensation structure.

Research has found that media coverage plays an important role in creating a CEO's reputation (Graffin et al., 2012). For example, the media's depiction of the CEO informs issues such as legitimacy, leadership skills, and effective strategic management abilities that would otherwise be less salient to shareholders through demographic information by signaling the quality of the CEO and CEO's actions to the shareholders (Dyck & Zingales, 2002; Miller, 2006). Recent reviews of reputation have established the importance of both the prominence of the CEO within the media (reputation awareness) and the specific qualities for which the CEO or firm is known (reputation for a capability)in reducing information asymmetry associated with firm decisions for outside stakeholders (Boyd et al., 2010; Lange et al., 2011).

Signals that diminish shareholders' information asymmetry

Credibility problems often exist with the information sources from the firm. The firm, as a primary source of information, is inclined to disclose positive information, to misrepresent abilities that are hard to validate, and to withhold damaging information (Spence, 1973). For this reason, scholars acknowledge the influence the media and third party "watchdogs" have on the shareholders' views of corporate governance; the signals from the media reduce the information asymmetry between management and external stakeholders by serving as an independent, seemingly objective source (Bednar, 2012; Dyck & Zingales, 2002; Miller, 2006). As a firm's decision-making processes are not transparent to its external stakeholders, information about organizational intentions, capabilities, and limitations is not readily available to the shareholders (Rindova et al., 2005). In the absence of perfect information, reputation (Fombrun, 1996) can serve as a signal of quality (positive or negative), thereby reducing uncertainty for shareholders (Rindova & Fombrun, 1999). Specifically, research has introduced media reputation as a signal of the quality or characteristics of the person or firm (Deephouse, 1996; Staw & Epstein, 2000).

This signal may be especially important to reducing shareholders' uncertainty, because shareholders tend to ignore important information released from the firm when the firm enacts major change (Cohen & Dean, 2005; Spence, 1976). CEO reputation is a concept in its infancy in scholarly research; however, CEO reputation is known to be influential for reducing uncertainty by signaling the level of quality in the midst of unavailable or ambiguous information about the executive (Graffin et al., 2012).

Shareholders, as recipients of the reputation signals, have their perceptions of the CEO influenced by the perceived honesty of the signaler, the frequency of the signal, and the signal fit (the extent to which the signal or public information is related to the unobservable or private information) (Connelly et al., 2011). Thus, the media, in the role of the signaler, actively influences the shareholders' perception and assessment of the CEO and firm, in so far as it serves as an influential source for both visibility and content of the reputation (Rindova et al., 2006).

Some executives gain a disproportionate amount of media attention. Research on CEO reputation awareness illustrates that media prominence instills in the shareholders a perception of legitimacy for the CEO (Rindova & Fombrun, 1999). This may serve as way for the shareholders to make a judgment in the absence of the specific information regarding the capability of the CEO. Endorsements of the CEO that occur in the media may serve as a signal to shareholders that the CEO has the capacity to manage competently (Khurana, 2002a). Specifically, positive business coverage of the CEO can lead stakeholders to grant CEOs greater control over the firm (Hayward et al., 2004). CEOs with high levels of public visibility may attract high quality human resources and access to capital at discounted rates (Fombrun, 1996).

Shareholders observing that the new CEO has reputation awareness within the media will be more likely to associate that CEO with legitimacy and financial success for firms with which s/he has been involved and less likely to associate the CEO with adverse selection. High levels of media attention may not always add additional value for the shareholders. Initial media attention may present valuable information for reducing uncertainty; however, significant amounts of media attention may have an incrementally diminishing added value to the shareholder. Thus, the incremental positive effect that information may have on reducing the information asymmetry and uncertainty to the shareholders may diminish where large quantities of media attention exist. These arguments lead to the following hypothesis:

> *Hypothesis 1: The reputational awareness of the CEO successor affects the stock market reaction to a CEO selection positively, and at a diminishing rate.*

The signals of reputation for a capability

Research has found that media coverage plays an important role in creating a CEO's reputation (Graffin et al., 2012). For example, the media's depiction of the CEO informs issues such as legitimacy, leadership skills, and effective strategic management that would otherwise be less salient to owners through demographic information by signaling the quality of the CEO and CEO's actions to the shareholders (Dyck &

Zingales, 2002; Miller, 2006). However, scholars to date have used demographic characteristics to determine whether a CEO appears to be qualified and a good fit for a particular position. For example, outside CEOs with prior CEO experience are assumed to have the capability to develop a strategic vision for the firm, manage complex decision-making processes, and communicate effectively with both employees and external stakeholders (Graffin et al., 2011). However, two candidates for the position of CEO with a similar resume may have vastly different abilities and motivations to serve the CEO role. Moreover, the positive or negative reputations of the CEOs may reveal more differences between two executives than what is present on a resume. For two CEOs with similar resumes, one CEO may have a reputation for leadership skills; the other may have a reputation for poor communication with internal stakeholders and the top management team. Therefore, although these CEOs may have similar demographic and experiential characteristics and firm performance these CEOs' reputations and the perceptions by the shareholders may differ.

Reputations for capabilities can potentially reduce information asymmetry by serving as a proxy for directly observable characteristics or quality of the CEO or firm. In particular, Mishina et al., (2012) note that reputations for a capability can be an important signal of quality and performance when shareholders are facing uncertainty resulting from information asymmetry. Although Mishina and colleagues (2012) have derived the antecedents of the reputations for capabilities and how these reputations change over time, research has yet to empirically test how these reputations affect shareholders' reactions to the adverse selection problem. As such, shareholders view the capability reputations of the successor CEOs, in their prior roles as CEOs, to determine how effective the CEO will likely be in the future.

A CEO's reputation for the capability of leadership is the perception of the ability to motivate action within the firm (Osborn, Hunt, & Jauch, 2002) and also to serve as a symbol of successful leadership in the press (Fannelli & Misangyi, 2006). Stakeholders (i.e., shareholders) believe that the leadership ability of the CEO is integral to the successful management of an organization (Waldman, Ramírez, House, & Puranam. 2001). Recently, scholars have built on the romance of leadership concept to theorize that media attention, firm performance, and a CEO's compensation add to a reputation for leadership as perceived by stakeholders (Treadway, Adams, Ranft, & Ferris, 2009).

A positive CEO reputation for the capability of leadership sends a signal to shareholders that a firm has a clear sense of direction (Salancik & Meindl, 1984). Even CEOs with limited discretion may gain advantage from the reputation for effective leadership in that the CEOs can symbolize the legitimacy of the office (Meindl, Ehrlich, & Dukerich, 1985). Scholars have noted that a reputation for quality leadership enhances CEOs' ability to influence others and increases their leadership capacity (Ketchen, Adams, & Shook, 2008). As such, it is thought that successful CEOs effectively communicate with and motivate employees (Andrews, 1971). Also, the CEO's symbolic management influences the perception of the external stakeholders of the organization's effectiveness (Fannelli & Misangyi, 2006). Thus, when the CEO has a reputation for the capability of leadership, the shareholders consider that this CEO is likely to have a positive effect on the future of the firm and thus, is a favorable selection. Drawing on these arguments, I hypothesize:

> *Hypothesis 2: A firm hiring a CEO with a high level of reputation for the capability of leadership has a positive effect on the shareholders' reaction to the CEO selection.*

Recent research indicates that CEOs with a favorable reputation (those with Ivy League degrees) had higher and longer sustaining firm market valuations than those CEOs without the Ivy League degree (Miller, Xiaowei, & Mehortra, in press). A reputation for the capability of leadership is one component that suggests a favorable CEO selection to the shareholders. In addition to effective leadership, the newly appointed CEO is expected to effectively choose the strategic direction of the firm and implement strategic changes that lead to positive firm performance (Ocasio, 1994; Datta, Rajagopalan, & Zhang, 2003). Newly appointed outside CEOs lack direct experience with the firm resources (e.g., human, physical, etc.) and may cause significant disruption as they enact change (Zhang & Rajagopalan, 2010). A reputation for effective strategic management may reduce uncertainty concerning the successor's potential disruption and influence the shareholders' perspective on a favorable selection.

A reputation for the capability of effective strategic management is important to the CEO selection process, as new CEOs enact more change to the strategic management of the firm within the first two and one-half years in office than later in their career (Gabarro, 1987; Finkelstein et al., 2009; Zhang, 2008). Specifically, new CEOs from outside the firm are more likely to make changes to the strategic direction of the firm, because of either the going-in-mandate or a lack of path dependence, or both (Finkelstein al., 2009). The newly appointed CEO is particularly important in the conversion of strategic changes to successful firm performance (Virany et al., 1992; Zhang & Rajagopalan, 2010). Outside CEOs are already viewed as having new or unique knowledge and skills that can be used to effectively facilitate strategic management change (Harris & Helfat, 1997).

However, enacting strategic change is not the only facet of effective strategic management. The CEO must also manage the firm to create and sustain competitive advantage. Sustained competitive advantage is composed of two sources, superior skills and resources (Day & Wensley, 1988). Thus, human capital can be a source of sustained competitive advantage (Coff, 1997). CEOs make many decisions that affect the firm's resources. These decisions that influence the selection an accumulation of resources that create competitive advantage, central to effective strategic management, are limited by the information, beliefs and biases of management (Oliver, 1997). The shareholders therefore must acknowledge that the CEO capability to effectively select or use resources to create competitive advantage may be a source of competitive advantage (Campbell, Coff, & Kryscynski, 2012).

Thus, a CEO with a positive reputation for the capability of strategic management for both strategic change and managing for sustained competitive advantage will be viewed by shareholders as a favorable selection to the position of CEO. These arguments lead to the following hypothesis:

Hypothesis 3: A firm hiring a CEO with high reputation for the capability of strategic management has a positive effect on the shareholders' reaction to the CEO selection.

The signals of the perceived going-in-mandate

Shareholders' reaction to the selection of a new CEO is contingent on not only the characteristics of the new CEO, but also on the context of the firm (Chen & Hambrick, 2012).

In the early stages of tenure, CEOs are focused on the going-in-mandate for which they were selected (Souder et al., 2012). The new, external CEOs tend to make strategic and human resource changes as directed by the going-in-mandate set by the BoD, rather than the CEO's inclination for immediate change (Hambrick & Fukutomi, 1991). Shareholders take what little information they do know about the going-in-mandate into consideration when reacting to the CEO selection, as the selection often signals to external stakeholders that a BoD desires to enact dramatic change in the organization (Suchman, 1995). When a firm is profitable, CEO selection may signal to shareholders an undesired change from the status quo within the hiring firm (Friedman & Singh, 1989). As a result, shareholders may perceive an adverse selection based on the firm's performance at the time of the adverse selection. Thus, an adverse selection may be determined by the shareholders regardless of the quality of the successor, if the shareholders' perception is that the going-in-mandate does not specifically identify needs of the firm that a new CEO could fill.

The context within which the selection occurs may matter to shareholders. For example, Davidson, Worrell, and Dutia (1993) found that although shareholders react negatively to bankruptcy filing, they react positively to an outside successor both before and after bankruptcy. Thus, the shareholders' perception of the going-in-mandate, specifically, when a firm has a going-in-mandate that identifies those skills which are generally sought in a new appointed CEO, may play a role in the market's reaction to a succession event. The perceived going-in-mandate may present an opportunity for the shareholders to understand the strengths and deficiencies of the firm. Firms that appear to have specific strengths concerning leadership or effective strategic management by the former CEO may be met with a negative reaction to the new CEO appointment regardless of the quality of the new CEO. Whereas, firms that illustrate a specific need for leadership or strategic management may have a positive market reaction to the succession event.

> *Hypothesis 4a: A firm that presents a perceived going-in-mandate of the capability of leadership has a positive effect on the shareholders' reactions to the CEO selection.*

> *Hypothesis 4b: A firm that presents a perceived going-in-mandate of the capability effective strategic management has a positive effect on the shareholders' reactions to the CEO selection.*

The BoD's signal of adverse selection

The BoD tries to select the most capable CEO; however, board members may still have reservations about the CEO selection given the incomplete information that exists when hiring an outside CEO successor. Hiring an outside successor requires balancing a unique CEO skill set with the uncertainty of the quality of the CEO due to information asymmetry (Harris & Helfat, 1997). Shareholders lack the information about the CEO successor and the going-in-mandate that the BoD has when it selects a CEO and actively attempt to gain access to additional information about the CEO selection process (Graffin et al., 2010).

In addition to the CEO successor's reputation for capabilities, shareholders may look for a signal from the BoD as to the likelihood of the adverse selection of the new CEO. Scholars have identified an assortment of CEO characteristics that can serve as additional objective signals to shareholders (Certo et al., 2001; Goranova et al., 2007). Specifically, signals have been used within corporate governance to express the quality and legitimacy of management, the accuracy of monitoring, and the minimization of goal incongruence (Certo et al., 2001; Goranova et al., 2007; Filatochev & Bishop, 2002; Zhang & Wiersema, 2009).

Although reputation for the capability of leadership may diminish the information asymmetry between the shareholders and firm, the reputation does not disclose the BoD's belief about the remaining information asymmetry between the BoD and the CEO successor. The BoD has significantly more information about the new CEO than is disclosed to the shareholders; however, shareholders form an opinion about the CEO successor from the reputation that is built overtime. The newly appointed CEO's compensation can serve as a signal to attenuate or strengthen the shareholders existing belief of the CEO's reputation for the capability of leadership.[8] CEO compensation may not present enough information for the shareholders' to form an opinion about the

8 Thanks to the committee member who pointed out an alternative explanation. Some firms may be forced to pay above market for a candidate for the CEO position, if that position is viewed as unattractive relative to the candidate.

quality of the newly appointed CEO;[9] nonetheless it may signal a level of information asymmetry as perceived by the BoD.

The driving forces behind the compensation package for a new CEO are the supply and demand of the managerial labor market and the skills and abilities of the CEO (Finkelstein et al., 2009; Zajac & Westphal, 1995). A firm that hires an outside successor with valuable skills and abilities competes with the candidate's current employer as well as other firms seeking a new CEO. The BoD adopts CEO compensation packages to compete against other firms to attract talented CEOs (Gomez-Mejia &Welbourne, 1988; Werner, Gomez-Mejia, Mejia& Tosi, 2005). While performance-contingent compensation is often cited as a factor to motivate goal congruence between the shareholder and the CEO, performance-contingent compensation is also a symbolism to shape stakeholders perception of the CEO (Westphal & Zajac, 1994). An organization may seek to influence the decision-making of a CEO by not only hiring the CEO most likely to perform well, but also compensate the CEO in a way that ensures maximum firm performance (Zajac, 1990). Early research into CEO selection found that the firms in which CEOs realize a direct link between the performance of the firm and their personal finances are more profitable (Zajac, 1990; Pandher & Currie, 2013). Thus, the motivational link between the effect that CEO compensation has on market perceptions of the newly hired CEO seem clearly defined; CEOs with a reputation for the capability of leadership who are also properly motivated

9 Because CEO compensation provides limited information about the quality of the CEO, I choose not to examine the relationship between the CEO's contingent compensation and the market's reaction to the new CEO announcement, but rather recognize that compensation may attenuate the relationship between reputation and the market reaction to the new CEO announcement.

to maximize shareholder value will be more positively received by the market. Summarizing these arguments, I propose:

> *Hypothesis 5a: The CEO's proportion of performance-contingent compensation positively moderates the relationship between the CEO's reputation for the capability of leadership and the shareholders' reaction to the CEO selection.*

The BoD's signal in the form of the compensation structure will also moderate the relationship between the reputation for the capability of strategic management and the market reaction to the announcement of the CEO. The signal of the performance contingent compensation may have a similar moderating effect on the relationship between reputation for the capability of strategic management and the market reaction to the CEO selection announcement than the effect on the reputation for the capability of leadership has on this relationship.

Although performance-contingent compensation may serve as a signal of the BoD's belief in a favorable or adverse selection, this type of compensation can also serve as a motivating factor for changes to the strategic management enacted by the newly appointed CEO. Since the CEO reputation for the capabilities of effective strategic management encompass both changes to the strategic management and gaining and sustaining competitive advantage. Scholars have found that CEOs with performance-contingent compensation lead firms to higher levels of strategic management change and risk-taking (Larraza-Kintana et al., 2007; Sanders & Hambrick, 2007; Williams & Rao, 2006). Research has also found that outsider CEO successors are more successful at turning strategic change into firm performance increases than insiders

(Zhang & Rajagopalan, 2010). The shareholders must acknowledge that the contingent compensation has the effect of increasing both the strategic change that is taken and potentially adding motivation to the CEO to more effectively implement strategic management changes to create sustained competitive advantage. Thus, a higher proportion of performance-contingent compensation may be a positive signal for the CEO's favorable selection as it suggests the alignment of goals between the outside successor hired to enact and successfully implement strategic management changes and the BoD that selected the CEO. Thus, I hypothesize:

> *Hypothesis 5b: The CEO's proportion of performance-contingent compensation positively moderates the relationship between the CEO's reputation for the capability of effective strategic management and the shareholders' reaction to the CEO selection.*

The perception of CEO fit

Appointing any executive as the new CEO is not likely to garner the same performance increases as appointing a CEO successor especially chosen with the skills, abilities, and experience necessary to meet the challenges associated with specific firm needs. This statement is the premise of the "fit-drift/shift-refit" model of CEO selection presented by Finkelstein and colleagues (2009). According to Finkelstein et al., (2009), the BoD begins the CEO selection process by determining a going-in-mandate based on the future needs of the firm (Vancil, 1987). For instance the going-in-mandate may present leadership (Warner et al., 1988) or strategic management needs of the firm (Virany et al., 1992). This going-in-mandate may identify unmet needs due to the changes in the nature of the firm context and the departing CEO's inability to adapt.

Thus, a CEO selection presents an opportunity to realign the CEO's capabilities to the going-in-mandate. The best shareholder reaction to a CEO selection is likely to come from a CEO that matches the firm requirements (Datta & Rajagopalan, 1998). Specifically, research has found that the fit between a new CEO and the industry context (Datta & Rajagopalan, 1998) or the firm needs (Chen & Hambrick, 2012) leads to performance improvements.

When CEOs are appointed, the extent to which they are perceived to meet the needs of the firm may affect the market's reaction to the appointment announcement. Firms that capitalize on the benefits associated with a successful CEO selection have an orderly succession process and minimize disruption to the firm (Chen & Hambrick, 2012). As such, a CEO who may fit well for one going-in-mandate may not be well suited for another going-in-mandate (Carpenter et al., 2001). For example, when a firm with a going-in-mandate for leadership hires a CEO with a positive a reputation for the capability of leadership (i.e., CEO successor fit), the "fit" may exponentially enhance the positive relationship between CEO quality and the shareholders' perception of adverse selection. This is consistent with recent CEO selection fit research that finds that firms with specific identifiable needs will have significant benefit from a new CEO that has capabilities that fit the going-in-mandate of the firm (Chen & Hambrick, 2012). Thus, I hypothesize:

> *Hypothesis 6a: The perceived going-in-mandate for the capability of leadership positively moderates the relationship between CEO's reputation for the capability of leadership and the shareholders' reaction to the CEO selection.*

Hypothesis 6b: The perceived going-in-mandate for the capability of effective strategic management positively moderates the relationship between CEO's reputation for the capability of effective strategic management and the shareholders' reaction to the CEO selection.

METHOD

Sample and sampling issues

The population for this study is large, publicly traded U.S. corporations within which a CEO succession has occurred. Consistent with prior CEO succession samples, the sample for this study was drawn from EXECUCOMP (Zhang & Rajagopalan, 2003). This sample was chosen over a 20 year time period, 1992-2011, to provide for adequate sample size. I first identified all outside CEO successors from EXECUCOMP. This time period of 1992-2011 represents a time for which the prominent, high circulation print media has become an easily accessible signal of information about a firm to its stakeholders (e.g., shareholders) (Bednar, 2012). I then identified the outside successors that also had prior experience as a CEO.

This dissertation sample was specifically chosen to control for confounding factors. There could be a significant difference in the level of information asymmetry between insider and outsider successors. For this reason, only outside CEO successors were chosen for this sample. Additionally, some CEOs may appear more qualified than other CEOs; therefore, this sample has CEOs which all appear to have the qualifications for the position of a CEO (i.e., prior experience as a CEO). These factors if not controlled for may serve as alternative explanations for the shareholders' perception of adverse selection.

After missing information was excluded, the final sample included *189* total succession events for which CEO successions occurred. Using the sample of CEO appointment announcements, I searched LexisNexis to compile a collection of print articles on each specific CEO successor and hiring firm for the one year prior to the succession announcement. The LexisNexis data base was used because it includes daily newspapers and reflects the attention of the general public (Kotha, Rajgopal & Rindova, 2000). To ensure useful media articles, I scanned the titles and abstracts of the articles for relevance and limited the media outlets to large circulation and high impact print news sources as available in LexisNexis search criteria (Lee & James, 2007). Data describing prior CEO and successor CEO characteristics (e.g., age, tenure, etc.) also are compiled from EXECUCOMP, while data on firm and industry metrics were obtained from COMPUSTAT. Consistent with Graffin and colleagues' work (2008; 2011), who also acquired information on executive careers, I searched Zoominfo.com for information on the successor's BoD service.

Variables

Independent Variables

CEO reputation awareness. The awareness of reputation was measured counting the total number of articles within the LexisNexis sample that mention the CEO successor in the year prior to the CEO announcement (Rindova et al., 2005; Milbourn, 2003). Consistent with prior research within strategic management these articles were compiled from major print media sources with high circulation, those sources specified in the LexisNexis database search criteria as print media with the largest audience reach (Lee & James, 2007). This measure has established validity both for the use of empirical studies (Rindova, et al. 2005) and as a major component of the reputation construct as suggested in a recent review of reputation literature (Lange et al., 2011).

CEO reputation for a specific capability. A limitation of existing reputation research is that reputation is infrequently measured directly (Rindova et al., 2005). This study addresses this limitation of the prior research on reputation by developing two measures for reputations for a specific capability. These reputations for a capability are consistent with the theoretical work that a new CEO, specifically an outsider, must have several key capabilities in order to effectively take over as the new CEO as an outsider, namely the capabilities to provide effective leadership and to strategically manage the firm.

I created a measure of reputation for each of the two dimensions of successor capability: leadership and strategic management. The Janis-Fadner coefficient of imbalance was used to create these measures (Deephouse, 2000). The Janis-Fadner coefficient was originally established to determine the favorability or un-favorability of a particular topic through the use of context analysis (Janus & Fadner, 1943). This measure, which quantifies media tonality, has previously been used to capture the character dimensions of reputation, such as environmental, conforming behavior, and general media favorability (Philippe & Durand, 2011). The Janis-Fadner coefficient of imbalance, in this measure, reputation for a capability utilizes the relative number of positive (p) and negative (n) mentions of a CEO in reference to a) leadership and b) strategic management in the given year prior to appointment announcement.

Media tonality values range from −1 to 1, where −1 represents all negative coverage, 1 indicates all positive coverage.

media tonality =

$(p^2 - p.n)/(p + n)^2$ if $p > n$;

0 if $p = n$; and

$(p.n - n^2)/(p + n)^2$ if $n > p$.

The dictionaries used for the rater to determine leadership and strategic management capabilities come from prior analysis concerning leadership (Meindl et al., 1985) and strategic actions (Miller & Chen, 1994). Thus, raters coded each article for the presence of each reputation for a capability, and then inter-rater agreement was calculated. After coding all articles, the Linguistic inquiry word count (LIWC) program was used to determine the media tonality for each group of articles associated with each CEO and reputation for a capability. LIWC is a software program developed to calculate the degree to which different categories of words are used in passages of text. LIWC has a positive and negative word dictionary that allows the program to determine the rate at which positive or negative words exist in a passage. The use of this program allowed the determination of positive and negative content words in the article, presenting a count of the positive and negative words. (Ten percent of the sample was also coded by a rater and the level of agreement between LIWC and rater was calculated.) Articles with more than 50 percent positive word count were coded as positive, articles with more than 50 percent negative word count were coded as negative, and the remaining articles were coded as neutral for the Janis-Fadner coefficient calculation. Sensitivity analysis was used post-hoc at rates of more than 60 percent and more than 40 percent in addition to the more than 50 percent used for the Janis-Fadner coefficient.

The interrater reliability in Table 1 for both CEO and firm reputation for a capability for leadership and strategic management for 91,160 articles was measured by 7 raters, with 2 raters assessing each article. Of all the inter-rater reliability (IRR) calculated for the presence of leadership and strategic management mentioned in the articles, the IRR range was between .93 and .97. Agreement between rater 1 and 2 was .93 and covered 27 companies and 26,359 articles. Agreement between rater 1 and 3 was .96 and covered 25 companies and 15,575 articles. Agreement between rater 1 and 4 was .95 and covered 23 companies and 15,009 articles. Agreement between rater 1 and 5 was .97 and covered 31 companies and 14,254 articles. Agreement between rater 1 and 6 was .93 and covered 28 companies and 12,066 articles. Agreement between rater 6 and 7 was .93 and covered 55 companies and 7,897 articles.

Table 1
Interrater reliability among raters

	Rater 1			Rater 7		
	IRR	**No. of Companies**	**No. of Articles**	**IRR**	**No of Companies**	**No. of Articles**
Rater 2	0.93	27	26,359			
Rater 3	0.96	25	15,575			
Rater 4	0.95	23	15,009			
Rater 6	0.95	31	14,254			
Rater 6	0.93	28	12,066	0.93	55	7,897

To assess the reliability of the computerized linguistics program used for the analysis, a subsample of the articles used for analysis was rated by both the program and a rater. The inter-rater reliability between rater 1 and the LIWC program regarding the positive and negative mentions in the articles covered 25 companies and 15,667 articles.

The agreement was higher for those positive and negative mentions of leadership (.93) than those mentions of strategic management (.76). The LIWC program results were used to test the hypotheses.

CEO compensation. Data on first year CEO salary and stock options were drawn from COMPUSTAT's EXECUCOMP database. Consistent with previous CEO compensation studies, total CEO compensation consists of salary, bonus, long-term incentive pay (LTIP), stock options awarded, and other compensation (Hambrick & Finkelstein, 1995; Henderson & Frederickson, 1996). The proportion of performance-contingent compensation is the ratio of performance contingent compensation (stock options, LTIP, and bonuses) to the total CEO compensation.

Firm reputation for a capability. Similar to the CEO reputation for a capability, the firm's reputation for a capability is measured through the use of the content analysis of Lexis Nexis newsprint, media articles of the hiring firm for the year preceding the appointment announcement. The firm reputation for the lack of a capability of leadership (going-in-mandate for leadership) and strategic management (going-in-mandate for strategic management) were collected by the raters using the measure and method of media tonality used for the CEO reputation for a capability constructs, focusing on the firm level reputation capabilities for the hiring firm. The Janis-Fadner coefficient has recently been used to determine the firm attribute of conforming behavior, a character reputation - a similar measure to the reputation for a capability - at the firm level (Philippe & Durand, 2011). Thus, when a firm reputation for a capability is low, then the firm has a going-in-mandate that notes a need for that capability in the firm. The selection of a CEO with a reputation for that capability would fit this need during the selection process.

Dependent Variable

Cumulative abnormal adjusted return. To test the hypotheses, the dependent variable is a firm's cumulative abnormal adjusted returns (CAR) over the three day window (-1, +1) surrounding the CEO successor announcement. This window allows for the capture of information prior to the event and responses on the day after the event (McWilliams & Siegel, 1997; Zhang & Wiersema, 2009). EVENTUS (WRDS) was used to calculate CARs estimating the market model using a 255-day window ending 46 days prior days prior to the succession announcement (Wade, Porac, Pollock, & Graffin, 2006; Shen & Cannella, 2003; Zhang & Wiersema, 2009). This is a model that has proven successful at capturing new information's effect on the difference between the firm's actual return and the predicted return for the three day window.

McWilliams and Siegel (1997) present several key problems associated with event studies that the researcher should address. First, the trading volume should be sufficient to allow for event analysis. To deal with this issue, I have chosen a sample of large, publically traded firms. The second issue is the appropriate event window choice. I measure the dependent variable by the means of the previously established event window that exists within the succession literature that has proven to effectively assess the abnormal returns resulting from succession (Zhang & Wiersema, 2009). Third is the problem of confounding events that may influence the stock price at the same time that the CEO succession event announcement. To address this concern I have controlled for the simultaneous announcement of the CEO selection and announcement of the outgoing CEO and have controlled for occurrence of other significant events, such as changes to the top management team, acquisition decisions or new alliances that may happen during the event window time frame. The fourth issue is the sensitivity to outliers. To address this potential problem, extensive analysis of the descriptive statistics of all variables has allowed for the identification of any outliers. This analysis showed that no cases had undue influence on the sensitivity of the analysis. Lastly, a sufficient sample size is necessary for an effective event analysis. A sample of 189 produces a desired statistical power of .85, based on recent research effect sizes of CEO succession event studies and the p value of .05.

Control Variables

Given results reported in the extant CEO succession literature, I control for the following variables: hiring firm size; hiring firm performance; prior CEO's tenure, duality, and CEO dismissal; successor's prior firm's performance, inter-industry succession, duality, board service, and prior CEO tenure as a CEO. I also controlled for whether or not the announcements of the incoming CEO and outgoing CEO occurred concurrently and the presence of confounding press releases.

As this study examines causal relationships associated with a stock market reaction to an event, there is a concern of endogeneity. Specifically, there could be a concern that the CEO announcement may be correlated to an unobservable variable which results in a change in stock price. Therefore, consistent with prior CEO announcement event studies (Graffin, Boivie, & Carpenter, in press; Wade et al. 2006), I ran two-stage equations. The first equation predicted the stock market reaction to the new CEO appointments, by including the following one year lagged variables: return on assets (one year ROA compiled from COMPUSTAT), stock market performance (one year percent change in stock price), dummy variables for the prior CEO dismissal, announcement, confounding and new CEO’s board service experience, CEO age, CEO tenure, change in industry ROA, and change in industry market performance to predict the stock market reaction to the CEO succession. Thus, this instrumental variable was used as a control variable in the hypothesis testing equations.

Consistent with prior event analysis of CEO succession events, firm size was measured as the average sales for the three years prior to succession, collected from COMPUSTAT (Datta & Rajagopalan, 1998). To measure prior firm performance, I used an accounting measure, ROA (return on assets) averaged for the three years prior to the succession event (Datta & Rajagopalan, 1998). Additionally, I controlled for whether the CEO succession was intra-industry or an industry outsider (Zhang & Rajagopalan, 2003).

Prior control variables used in CEO succession research have highlighted the context of the succession process including the characteristics of the prior CEO. Thus, I control for outgoing CEO tenure, calculated as the number of years the prior CEO served as a CEO (Graffin, Carpenter, & Boivie, 2011). Because dismissal represents a unique context of CEO selection (Finkelstein et al., 2009), I coded a dummy variable indicating a CEO who was fired. Developed by Shen and Cannella (2002), this variable determines dismissal when an outgoing CEO was less than sixty-five years of age and does not remain on the BoD after leaving the firm.

I controlled whether the outgoing CEO also held the chair of the board prior to the succession event (Graffin, Carpenter, & Boivie, 2011). Additionally, I have added dummy variables for when the press release of the CEO selection coincided with the press release about the outgoing CEO and other significant press releases that within +/−1 day of the CEO succession announcement, such as other top management team succession events, new alliances or joint ventures, lawsuits in which the firm is a party, etc. (McWilliams & Siegel, 1997).

Additionally, certain characteristics of the successor CEO could play a role in the confounding the relationship between reputation of the CEO and the shareholders' reaction to the succession event. Thus, I have controlled for the quality of the new CEO as the successor CEO's prior firm performance. It was calculated as an average ROA over three years prior to succession; the tenure of the successor's prior CEO experience; and the power of the successor CEO based on prior duality. Although most of these variables are available via EXECUCOMP, additional data are collected via the announcement of the succession appointment or from SEC filings.

Data analysis

CEO succession research has been criticized for a lack of consistent and robust findings (Pitcher et al., 2000). This criticism has been largely attributed to the difficulty measuring non-demographic CEO characteristics, since the use of demographics of the CEO do not capture the intended qualities of the CEOs. As such, there is an increasing focus on the use of qualitative and psychometric measures to address the characteristics of the successor CEO (Pitcher et al., 2000). Fredrickson, Hambrick, and Baumrin (1988) specifically note that scholars studying the succession event need to include the correct variables to control for confounding effects. They suggest the use of industry characteristics, firm characteristics (e.g., performance), the succession context (circumstances in which the prior CEO left), the power of the preceding CEO, and information about the successor CEO. Accordingly, this study addresses these issues. The independent variables are captured by a qualitatively based measure of the CEO capabilities, moderation variables address the measurement of the context within the firm prior to the succession event and the control variables address the confounding factors that prior research has established as being important for finding accurate results within a succession context.

Diagnostic statistics were used to identify non-normal distributions (skewness and kurtosis), mutlicolinearity, heteroscedasticity, and outliers. Prior CEO duality, successor CEO duality, prior CEO's firm performance, hiring firm performance, and CEO reputational awareness were found to have non-normal distributions; specifically, these variables all had skewness greater than the absolute value of 1. Therefore, these variables were transformed; the square root of both firm performance measures were calculated; whereas, the measures of CEO duality and reputational awareness were squared. Multicolinearity was not found to be a problem and there were no outliers that significantly affected the regression results. A correlation table is presented in the results section.

In this study, event study methodology is used to evaluate the abnormal returns caused as a result of the succession announcement. The use of event study methodology presents additional methodological challenges for the research. Understanding the key assumptions, design and implementation issues is essential to success for use with this methodology. It is also important to note the difference between event study and event history methodology. An event study is a method to determine the effect of an event on the market reaction to an event. An event history is a method to determine the factors that may influence the occurrence of an event or a change from one state to another.

The curvilinear relationships hypothesized in H1, H6a, and H6b have the variables of reputational awareness and the going-in-mandate variables centered and squared to facilitate testing these hypotheses. The moderating variables for H 5a, H5b, H6a, and H6b are centered and the resulting moderating coefficients are graphed with moderators at the mean and one standard deviation above and below the mean so as to facilitate ease of interpretation. Consistent with prior work that intersects the CEO succession and CEO reputation literature (Graffin et al 2011), a p-value of 0.05 was used to determine empirical support of the hypothesize relationships. Sensitivity analysis allows for a variation in the Janis-Fadner coefficient of imbalance as was previously addressed. Sensitivity analysis was done post-hoc at rates of more than 60 percent positive and more than 40 percent positive in addition to the more than 50 percent used for the Janis-Fadner coefficient.

RESULTS

A final sample size of 189 results in adequate statistical power to assess the six hypotheses proposed in this dissertation. Table 2 provides descriptive statistics and correlations for the variables in this dissertation. The 189 firms that hired new CEOs with prior CEO experience in this sample had an average return on assets (ROA) of -3.2 percent. Forty-one percent of these firms dismissed their prior CEO and 42.1 percent of firms chose CEOs with some prior experience within the industry and 88 percent of firms hired the new CEO with duality. The 189 newly hired CEOs had 5.5 years of prior experience as a CEO, and 54.9 percent of newly hired CEOs had prior experience on a BOD. Table 3 represents the models that test the direct hypotheses, H1, H2, H3, H4a and H4b; whereas, the table on page 84 represents the models that test the moderating hypotheses, H5a, H5b, H6a, and H6b. The tables on page 85 and 87 represent the sensitivity analysis results for the hypotheses with variables that use the media tonality construct; these tables present the media tonality for a positive count at 40 percent and the media tonality for a positive count at 60 percent.

Table 2
Descriptive statistics and correlations

	Variable	Mean	s.d.	1	2	3	4	5	6	7
1.	Hiring Firm Size	29.30	52.81							
2.	Hiring Firm ROA	0.05	0.21	0.02						
3.	Prior CEO Tenure	6.47	6.92	-0.06	-0.03					
4.	Prior CEO Duality	0.86	0.35	0.04	0.06	0.19**				
5.	Prior CEO Dismissal	0.55	0.50	-0.04	0.06	-0.18	-0.07			
6.	Interindustry Succession	0.44	0.50	-0.02	-0.05	-0.07	0.02	-0.01		
7.	Successor Duality	0.80	0.85	0.00	-0.03	-0.11	-0.02	0.07	0.04	
8.	Successor CEO's Prior Board Membership	0.53	0.51	-0.07	0.06	0.03	0.13	0.07	0.10	0.04
9.	Successor CEO's Prior CEO Tenure	5.52	4.33	0.10	0.02	-0.14	0.05	0.06	-0.04	0.05
10.	Announcement and Resignation	0.27	0.45	-0.08	-0.01	0.00	0.04	0.02	-0.07	0.08
11.	Confounding News	0.27	0.44	0.15*	-0.06	-0.04	-0.10	0.04	-0.04	-0.06
12.	Instrumental Variable	0.00	21.70	0.09	-0.06	0.00	-0.20	0.00	-0.02	-0.04
13.	Contingent Compensation	0.64	0.33	-0.12	-0.06	0.08	0.07	-0.04	0.01	0.06
14.	CEO Capability Reputation SM	0.14	0.17	0.08	-0.01	0.01	0.01	0.10	0.05	-0.02
15.	CEO Capability Reputation Leadership	0.36	0.35	0.13	0.15*	0.17*	0.08	-0.06	0.02	-0.02
16.	CEO Reputation Awareness	9.30	7.79	0.13	-0.08	-0.11	0.04	0.08	0.14	0.05
17.	Firm Capability Reputation Leadership	-0.25	0.32	-0.03	-0.07	-0.07	0.03	0.06	0.08	-0.20
18.	Firm Capability Reputation SM	-0.10	0.09	0.11	-0.03	-0.05	0.02	0.02	0.07	-0.01

n=189
* $p < 0.05$; ** $p < 0.01$

Table 2 Continued

	Variable	8	9	10	11	12	13	14	15	16	17
1.	Hiring Firm Size										
2.	Hiring Firm ROA										
3.	Prior CEO Tenure										
4.	Prior CEO Duality										
5.	Prior CEO Dismissal										
6.	Interindustry Succession										
7.	Successor Duality										
8.	Successor CEO's Prior Board Membership										
9.	Successor CEO's Prior CEO Tenure	0.05									
10.	Announcement and Resignation	-0.02	0.08								
11.	Confounding News	0.08	0.05	0.24**							
12.	Instrumental Variable	0.00	0.00	0.00	0.00						
13.	Contingent Compensation	0.05	0.04	0.03	0.01	0.02					
14.	CEO Capability Reputation SM	0.13	0.06	-0.09	-0.06	-0.02	-0.23				
15.	CEO Capability Reputation Leadership	0.06	0.03	-0.13	-0.14	0.12	-0.15	0.40**			
16.	CEO Reputation Awareness	0.05	-0.06	0.03	-0.09	0.01	-0.05	0.07	-0.11		
17.	Firm Capability Reputation Leadership	0.10	-0.02	0.07	0.08	0.03	0.10	-0.09	-0.22**	0.02	
18.	Firm Capability Reputation SM	0.00	0.03	0.05	0.03	-0.01	-0.02	-0.04	-0.02	0.14	0.47**

n=189

* p< 0.05; ** p< 0.01

Table 3
Direct effects of reputation on shareholder perception of adverse selection

	Model 1 (controls)		Model 2 (H1)		Model 3 (H2)		Model 4 (H3)		Model 5 (H4a)		Model 6 (H4b)	
	B	s.e.	B	s.e.	B	s.e.	B	s.e.	B	s.e.	B	s.e.
(Constant)	7.79**	(2.93)	8.34*	(3.49)	6.07	(3.49)	8.93*	(3.47)	7.77**	(3.71)	8.30*	(3.53)
Hiring Firm Size	-0.00	(0.01)	-0.00	(0.01)	0.00	(0.01)	0.00	(0.01)	-0.00	(0.01)	0.00	(0.01)
Hiring Firm ROA	-2.15	(2.80)	-2.81	(3.16)	-3.98	(3.11)	-2.92	(3.17)	-2.99	(3.20)	-2.95	(3.29)
Prior CEO Tenure	-0.17	(0.08)	-0.20*	(0.10)	-0.26**	(0.10)	-0.19	(0.10)	-0.20	(0.10)	-0.20	(0.10)
Prior CEO Duality	-0.62	(2.32)	-1.23	(2.76)	-1.07	(2.68)	-0.87	(2.77)	-1.04	(2.77)	-1.10	(2.77)
Prior CEO Dismissal	2.30	(1.18)	2.13	(1.50)	2.27	(1.46)	2.36	(1.52)	2.16	(1.50)	2.17	(1.53)
Successor’s Firm Prior ROA	-3.79	(6.89)	-3.96	(8.18)	-1.47	(8.02)	-5.15	(8.29)	-3.44	(8.29)	-3.83	(8.26)
Interindustry Succession	1.50	(1.21)	2.10	(1.55)	1.94	(1.51)	2.11	(1.56)	2.17*	(1.57)	2.11	(1.56)
Successor Duality	-0.41	(0.61)	-0.49	(0.69)	-0.43	(0.67)	-0.54	(0.69)	-0.53	(0.70)	-0.53	(0.74)
Successor CEO's Prior Board Membership	-5.14**	(1.21)	-4.66**	(1.57)	-4.66**	(1.53)	-4.60**	(1.57)	-4.60**	(1.58)	-4.60**	(1.61)
Successor CEO's Prior CEO Tenure	0.45**	(0.14)	0.50**	(0.18)	0.48**	(0.18)	0.51**	(0.18)	0.50**	(0.18)	0.50**	(0.18)
Announcement and Resignation	-6.49**	(1.43)	-7.06**	(1.82)	-6.9	(1.78)	-6.98**	(1.83)	-7.03**	(1.83)	-7.03**	(1.85)
Confounding News	-4.43**	(1.49)	-4.32*	(1.85)	-3.78*	(1.82)	-4.53*	(1.86)	-4.32**	(1.87)	-4.38*	(1.87)
Instrumental Variable	1.00***	(0.03)	1.00**	(0.03)	0.99**	(0.03)	0.99**	(0.03)	0.99**	(0.03)	1.00**	(0.03)
CEO Reputation Awareness			0.01	(0.10)	0.03	(0.09)	0.01	(0.10)	0.01	(0.10)	0.00	(0.10)
CEO Reputation Awareness Squared			0.00	(0.01)								
CEO Capability Reputation Leadership					5.41**	(2.19)						
CEO Capability Reputation SM							-4.20	(4.62)				
Firm Capability Reputation SM									-4.57	(9.77)		
Firm Capability Reputation Leadership											-0.42	(2.64)
R squared	0.93		0.93		0.93		0.93		0.93		0.93	

n=189
* p< 0.05; ** p< 0.01

Hypothesis 1 states that the CEO reputational awareness or the number of articles about a CEO will be positively, but at a declining rate, related to the market reaction to the CEO appointment announcement. As seen in Table 3, the coefficient for CEO reputational awareness, a squared variable, ($\beta = 0.00$; ns) is not statistically significant. This result does not provide support for Hypothesis 1.

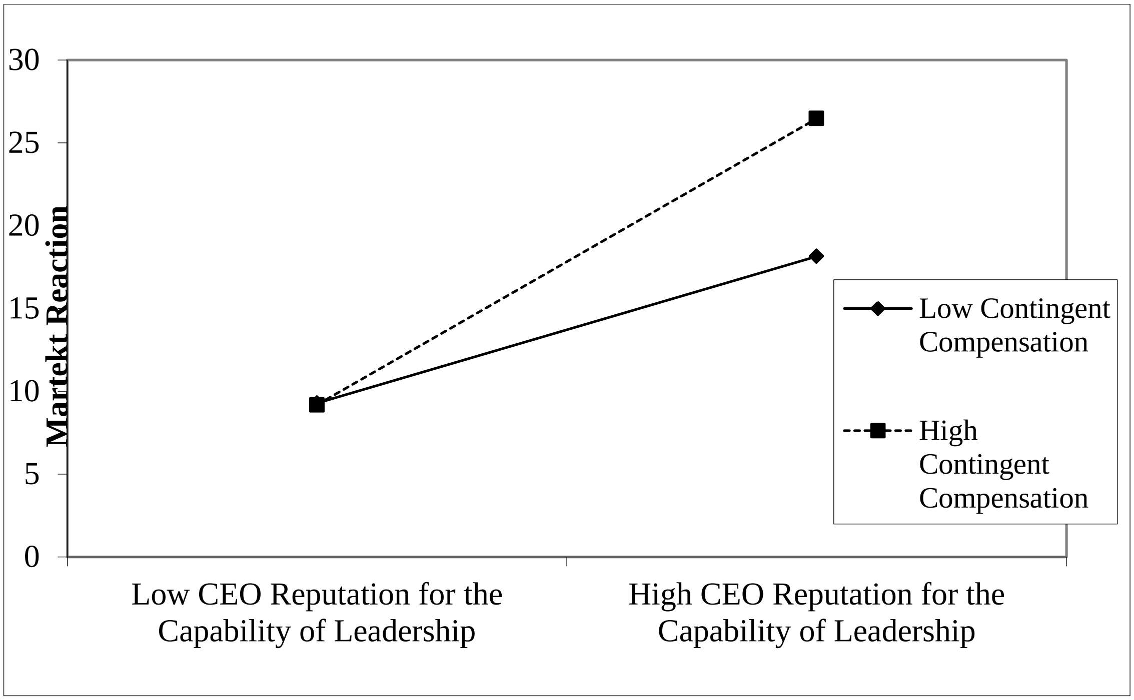
Hypothesis 2 states that a firm hiring a CEO with a reputation for the capability of leadership will experience a positive market reaction to the CEO appointment announcement. Hypothesis 2 receives support. The CEO reputation for the capability of leadership ($\beta = 5.14$; $p < 0.01$) has a positive effect on the market perception of the newly appointed CEO and is statistically significant.

Hypothesis 3 states that a firm hiring a CEO with a reputation for the capability of effective strategic management will experience a positive market reaction to the CEO appointment announcement. Hypothesis 3 is unsupported, CEO reputation for the capability of strategic Management ($\beta = -4.20$; ns) is the opposite of the predicted direction and not statistically significant.

Hypotheses 4a and 4b state that in firms that have specific needs or a going-in-mandate for leadership and strategic management capabilities presented in the media experience a positive reaction in the market to the announcement of a new CEO appointment. The coefficients of the effect of the going-in-mandates of leadership ($\beta = -4.57$; ns) and strategic management ($\beta =- 0.42$; ns) are not statistically significant, so they fail to provide support for hypothesis 4a and 4b.

The table on page 84 presents the moderation results of H5a, H5b, H6a, and H6b. Hypothesis 5a states that the firms with higher levels of new CEO contingent compensation have a stronger market reaction to the announcement of a new CEO with a reputation for leadership capabilities than those with lower levels of contingent compensation. Hypothesis 5b states that the firms with higher levels of new CEO contingent compensation have a stronger market reaction to the announcement of a new CEO with a reputation for strategic management capabilities than those with lower levels of contingent compensation. The moderation effect of contingent compensation on the relationship between the market reaction to the new CEO announcement and CEO reputation for leadership capabilities ($\beta = 18.26$; $p < 0.01$) and CEO reputation for strategic management ($\beta = 9.76$; ns) provide mixed results. H5a receives support and H5b fails to find support, respectively. Figure 2 presents the graphed interaction of H5a.

Figure 2. Contingent compensation's moderation effect on CEO reputation for the capability of leadership on the market reaction of the CEO succession.



Hypotheses 6a and 6b allude to the fit of the CEO to the needs of the firm. The firm having a going-in-mandate that states the need for leadership or effective strategic management, respectively, strengthens the positive relationship between the CEO's reputation for that capability and the market reaction to the announcement, as can be seen in table 4. The hypotheses of CEO fit, H6a ($\beta = -12.91$; ns) and H6b ($\beta = 0.38$; ns), do not receive support.

Thus, overall Hypotheses 2 and 5a find support. Only two of the nine hypotheses were supported. This is disappointing, given that at a significance level of 0.05, one of twenty hypotheses could be supported due to chance alone.

Additionally, sensitivity analysis at 60 percent and 40 percent present no substantive change from the 50 percent measure for the media tonality construct used in in the table on page 79 and the table on page 84. Specifically, Table 5 which represents the hypotheses at the media tonality of 40 percent supports Hypothesis 5a only. The variance for the Janis-Fadner coefficient for Hypothesis 2, is greater at the 40 percent level than the 50 percent level, which explains why the hypothesis is not supported at a p-value of 0 .05. This coefficient has a p-value of 0.12. Table 6 which represent the hypotheses at the media tonality of 60 percent fails to support any hypotheses. The Janis-Fadner coefficient when measured at 60 percent positive is a more stringent metric when looking for favorable reputation than is usually used in this type of analysis.[10] This more stringent metric has failed to find support for any hypotheses.

10 Work by Deephouse (2000) examined only the Janis-Fadner coefficient at 50 percent and did no sensitivity analysis. Recent work by Graffin and colleagues (2012) did sensitivity analysis at multiple levels finding consistent results.

Table 4
Reputational moderators' effects on shareholder perception of adverse selection

	Model 1 (controls)		Model 2 (H5a)		Model 3 (H5b)		Model 4 (H6a)		Model 5 (H6b)	
	B	s.e.	B	s.e.	B	s.e.	B	s.e.	B	s.e.
(Constant)	7.79**	(2.93)	9.27**	(3.50)	7.58*	(3.76)	8.22*	(3.52)	8.07*	(3.37)
Hiring Firm Size	-0.00	(0.01)	0.01	(0.01)	0.01	(0.015)	0.00	(0.01)	-0.00	(0.14)
Hiring Firm ROA	-2.15	(2.80)	-2.33	(4.13)	-2.48	(4.52)	-3.10	(3.23)	-3.61	(3.26)
Prior CEO Tenure	-0.17	(0.08)	-0.30**	(0.10)	-0.21	(0.11)	-0.20	(0.10)	-0.26*	(0.10)
Prior CEO Duality	-0.62	(2.32)	-1.51	(2.64)	-0.34	(2.90)	-0.80	(2.81)	-1.12	(2.71)
Prior CEO Dismissal	2.30	(1.18)	2.46	(1.55)	2.68	(1.69)	2.38	(1.54)	2.14	(1.50)
Successor's Firm Prior ROA	-3.79	(6.89)	-4.24	(8.71)	-5.81	(9.61)	-5.00	(8.64)	-1.67	(8.17)
Interindustry Succession	1.50	(1.21)	2.13	(1.57)	2.32	(176)	2.23	(1.59)	1.92	(1.55)
Successor Duality	-0.41	(0.61)	-0.61	(0.65)	-0.74	(0.72)	-0.57	(0.71)	-0.31	(0.73)
Successor CEO's Prior Board Membership	-5.14**	(1.21)	-5.56**	(1.58)	-4.50	(1.76)	-4.58**	(1.60)	-4.83**	(1.58)
Successor CEO's Prior CEO Tenure	0.45**	(0.14)	0.42*	(0.19)	0.48*	(0.20)	0.51**	(0.18)	0.49**	(0.18)
Announcement and Resignation	-6.49**	(1.43)	-5.86**	(1.90)	-5.82**	(2.09)	-6.94**	(1.84)	-7.00**	(1.81)
Confounding News	-4.43**	(1.49)	-3.52	(1.82)	-4.59*	(2.00)	-4.48**	(1.89)	-3.77*	(1.85)
Instrumental Variable	1.00***	(0.03)	1.01**	(0.03)	1.00**	(0.04)	0.99**	(0.03)	0.99**	(0.03)
CEO Reputation Awareness			-0.26	(0.11)	-0.08	(0.12)	0.01	(0.10)	0.03	(0.09)
Contingent Compensation			-0.35	(2.42)	-1.41	(2.68)				
CEO Capability Reputation Leadership			6.99**	(2.22)					5.71*	(2.31)
Contingent Compensation X CEO Capability Reputation Leadership			18.26**	(6.94)						
CEO Capability Reputation SM					-3.19	(5.24)	-4.44	(4.69)		
Contingent Compensation X CEO Capability Reputation SM					9.76	(14.53)				
Firm Capability Reputation SM							-4.75	(10.12)		
CEO Capability Reputation SM X Firm Capability Reputation SM							-12.91	(63.61)		
Firm Capability Reputation Leadership									1.24	(2.80)
CEO Capability Reputation Leadership X Firm Capability Reputation Leadership									0.38	(6.77)
R squared	0.93		0.93		0.93		0.93		0.93	

n=189

* p< 0.05; ** p< 0.01

Table 5
Sensitivity analysis for Hypothesis 2-6b media tonality at positive 40%

	Model 1 (controls)		Model 2 (H2)		Model 3 (H3)		Model 4 (H4a)		Model 5 (H4b)	
	B	s.e.	B	s.e.	B	s.e.	B	s.e.	B	s.e.
(Constant)	7.79**	(2.93)	9.15*	(3.48)	7.53*	(3.46)	7.20*	(3.57)	8.21*	(3.49)
Hiring Firm Size	-0.00	(0.01)	0.00	(0.01)	0.00	(0.01)	-0.01	(0.02)	-0.01	(0.02)
Hiring Firm ROA	-2.15	(2.80)	-1.89	(3.26)	-2.78	(3.15)	-2.78	(3.15)	-2.60	(3.16)
Prior CEO Tenure	-0.17	(0.08)	-0.20*	(0.10)	-0.20	(0.10)	-0.20*	(0.10)	-0.19*	(0.10)
Prior CEO Duality	-0.62	(2.32)	-1.14	(2.75)	-1.38	(2.75)	-1.38	(2.75)	-0.63	(2.79)
Prior CEO Dismissal	2.30	(1.18)	2.11	(1.49)	2.32	(1.49)	2.32	(1.49)	2.18	(1.49)
Successor’s Firm Prior ROA	-3.79	(6.89)	-3.39	(8.18)	-3.10	(8.16)	-3.10	(8.16)	-7.80	(8.81)
Interindustry Succession	1.50	(1.21)	1.99	(1.56)	1.70	(1.57)	1.70	(1.57)	2.25	(1.56)
Successor Duality	-0.41	(0.61)	-0.61	(0.70)	-0.42	(0.69)	-0.42	(0.69)	-0.57	(0.69)
Successor CEO's Prior Board Membership	-5.14**	(1.21)	-4.57**	(1.57)	-4.72	(1.56)	-4.72**	(1.53)	-4.74**	(1.57)
Successor CEO's Prior CEO Tenure	0.46**	(0.14)	0.49**	(0.18)	0.54**	(0.18)	0.54**	-0.18	0.51**	(0.18)
Announcement and Resignation	-6.49**	(1.43)	-6.50**	(1.89)	-4.35*	(1.84)	-7.36**	(1.83)	-6.97**	(1.82)
Confounding News	-4.43**	(1.49)	-4.49*	(1.85)	-7.36**	(1.83)	-4.35*	(1.84)	-3.98*	(1.89)
Instrumental Variable	1.00***	(0.03)	0.99**	(0.03)	1.00	(0.03)	1.00**	(0.03)	1.00**	(0.03)
CEO Reputation Awareness	0.01	(0.10)	0.00	(0.10)	0.04	(0.10)	0.04	(0.1)	0.01	(0.1)
Contingent Compensation										
CEO Capability Reputation Leadership			6.59	(4.67)						
Contingent Compensation X CEO Capability Reputation Leadership										
CEO Capability Reputation SM					-2.53	(2.4)				
Contingent Compensation X CEO Capability Reputation SM										
Firm Capability Reputation SM							6.59	(4.67)		
CEO Capability Reputation SM X Firm Capability Reputation SM										
Firm Capability Reputation Leadership									2.43	(2.09)
CEO Capability Reputation Leadership X Firm Capability Reputation Leadership										
R squared	0.93		0.93		0.93		0.93		0.93	

n=189
* p< 0.05; ** p< 0.01

Table 5 Continued

	Model 6 (5b)		Model 7 (5b)		Model 8 (H6a)		Model 9 (H6b)	
	B	s.e.	B	s.e.	B	s.e.	B	s.e.
(Constant)	7.27*	(3.49)	6.72	(3.72)	8.78*	(3.65)	8.49*	(3.45)
Hiring Firm Size	0.01	(.02)	0.01	(0.02)	-0.00	(0.02)	-0.01	(0.14)
Hiring Firm ROA	-2.02	(4.21)	-2.61	(4.62)	-2.70	(3.32)	-2.70	(3.10
Prior CEO Tenure	-0.22	(0.10)	-0.22*	(0.11)	-0.19	(0.10)	-0.19*	(0.10)
Prior CEO Duality	0.18	(2.69)	-0.48	(2.85)	-1.94	(2.84)	-1.94	(2.81)
Prior CEO Dismissal	2.64	(1.56)	2.64	(1.56)	2.06	(1.50)	2.06	(1.49)
Successor’s Firm Prior ROA	-9.14	(8.91)	2.37	(1.67)	-8.01	(9.16)	-1.07	(9.22)
Interindustry Succession	1.88	(1.64)	-3.29	(9.42)	2.12	(1.57)	1.34	(1.57)
Successor Duality	-0.43	(0.67)	2.02	(1.75)	-0.70	(0.70)	-0.36	(0.68)
Successor CEO's Prior Board Membership	-4.96**	(1.61)	-0.91	(0.72)	-4.66**	(1.57)	-4.22*	(1.60)
Successor CEO's Prior CEO Tenure	0.57**	(0.19)	-3.94*	(1.76)	0.50**	(0.18)	0.06**	(0.18)
Announcement and Resignation	-6.78**	(1.97)	0.51*	(0.21)	-6.34**	(1.90)	-6.99**	(1.84)
Confounding News	3.63*	(1.88)	-5.43*	(2.16)	-4.09*	(1.90)	-5.71**	(1.95)
Instrumental Variable	1.02**	(0.03)	-4.31*	(2.00)	0.99**	(0.03)	1.00**	(0.03)
CEO Reputation Awareness	-0.50	(0.11)	1.01**	(0.04)	-0.01	(0.10)	0.03	(0.10)
Contingent Compensation	-0.94	(2.45)	-0.09	(.12)				
CEO Capability Reputation Leadership	4.08	(5.10)					-2.67	(2.25)
Contingent Compensation X CEO Capability Reputation Leadership	43.64**	(14.40)						
CEO Capability Reputation SM			-1.56	(2.65)	7.40	(4.62)		
Contingent Compensation X CEO Capability Reputation SM			8.93	(8.18)				
Firm Capability Reputation SM					-6.65	(9.31)		
CEO Capability Reputation SM X Firm Capability Reputation SM					102.05	(51.60)		
Firm Capability Reputation Leadership							2.82	(2.34)
CEO Capability Reputation Leadership X Firm Capability Reputation Leadership							1.64	(6.50)
R squared	0.94		0.94		0.93		0.93	

n=189
* p< 0.05; ** p< 0.01

Table 6
Sensitivity analysis for Hypothesis 2-6b media tonality at positive 60%

	Model 1 (controls)		Model 2 (H2)		Model 3 (H3)		Model 4 (H4a)	
	B	s.e.	B	s.e.	B	s.e.	B	s.e.
(Constant)	7.79**	(2.93)	9.18*	(3.57)	7.49*	(3.73)	8.22*	(3.44)
Hiring Firm Size	-0.00	(0.01)	0.00	(0.01)	0.00	(0.01)	-0.01	(0.01)
Hiring Firm ROA	-2.15	(2.80)	-1.89	(3.26)	-3.01	(3.19)	-2.78	(3.17)
Prior CEO Tenure	-0.17	(0.08)	-0.20*	(0.10)	-0.20*	(0.10)	-0.20*	(0.10)
Prior CEO Duality	-0.62	(2.32)	-1.14	(2.75)	-0.89	(2.79)	-1.70	(2.86)
Prior CEO Dismissal	2.30	(1.18)	2.11	(1.49)	2.09	(1.50)	1.98	(1.51)
Successor’s Firm Prior ROA	-3.79	(6.89)	-3.39	(8.18)	-3.82	(8.20)	-0.47	(9.38)
Interindustry Succession	1.50	(1.21)	1.98	(1.56)	2.02	(1.56)	1.93	(1.58)
Successor Duality	-0.41	(0.61)	-0.61	(0.69)	-0.44	(0.69)	-0.47	(0.69)
Successor CEO's Prior Board Membership	-5.14**	(1.21)	-4.57**	(1.57)	-4.76**	(1.58)	-4.34**	(1.63)
Successor CEO's Prior CEO Tenure	0.46**	(0.14)	0.49**	(0.18)	0.52**	(0.18)	0.51**	-0.18
Announcement and Resignation	-6.49**	(1.43)	-6.50**	(1.89)	-7.16**	(1.89)	-7.25**	(1.85)
Confounding News	-4.43**	(1.49)	-4.49*	(1.85)	-4.51*	(1.85)	-4.80*	(1.94)
Instrumental Variable	1.00***	(0.03)	0.99**	(0.03)	0.99**	(0.03)	1.00**	(0.03)
CEO Reputation Awareness	0.01	(0.10)	-0.00	(0.10)	0.02	(0.10)	0.01	(0.1)
Contingent Compensation								
CEO Capability Reputation Leadership			3.12	(4.75)				
Contingent Compensation X CEO Capability Reputation Leadership								
CEO Capability Reputation SM					-2.53	(2.24)		
Contingent Compensation X CEO Capability Reputation SM								
Firm Capability Reputation SM							-7.28	(9.50)
CEO Capability Reputation SM X Firm Capability Reputation SM								
Firm Capability Reputation Leadership								
CEO Capability Reputation Leadership X Firm Capability Reputation Leadership								
R squared	0.93		0.93		0.93		0.93	

n=189
* p< 0.05; ** p< 0.01

Table 6 Continued

	Model 6 (5b)		Model 7 (5b)		Model 8 (H6a)		Model 9 (H6b)	
	B	s.e.	B	s.e.	B	s.e.	B	s.e.
(Constant)	6.73	(3.72)	6.61	(3.71)	9.02*	(3.65)	8.96*	(3.45)
Hiring Firm Size	0.01	(0.02)	0.00	(0.02)	-0.00	(0.02)	-0.01	(0.14)
Hiring Firm ROA	-2.60	(4.62)	-1.50	(4.48)	-1.48	(3.32)	-1.48	(3.10
Prior CEO Tenure	-0.22*	(0.11)	-0.16	(0.11)	-.19	(0.10)	-0.19	(0.10)
Prior CEO Duality	-0.49	(2.85)	-0.23	(2.84)	-0.75	(2.84)	-0.75	(2.81)
Prior CEO Dismissal	2.37	(1.67)	2.91	(1.66)	2.13	(1.50)	2.13	(1.49)
Successor’s Firm Prior ROA	-3.30	(9.42)	-5.84	(9.33)	-8.01	(9.16)	-8.01	(9.22)
Interindustry Succession	2.02	(1.75)	3.48*	(1.79)	2.12	(1.57)	2.11	(1.57)
Successor Duality	-0.91	(0.72)	-0.53	(0.71)	-0.70	(0.70)	-0.70	(0.68)
Successor CEO's Prior Board Membership	-3.94*	(1.76)	-5.16**	(1.73)	-4.66**	(1.57)	-4.66**	(1.60)
Successor CEO's Prior CEO Tenure	0.51*	(0.21)	0.48*	(0.20)	0.50**	(0.18)	0.49**	(0.18)
Announcement and Resignation	-5.43*	(2.16)	-5.09*	(2.10)	-6.33**	(1.90)	-6.335**	(1.90)
Confounding News	-4.31*	(2.00)	-5.45**	(2.02)	-4.09*	(1.89)	-4.10*	(1.90)
Instrumental Variable	1.01**	(0.04)	1.01**	(0.03)	0.99**	(0.03)	0.99**	(0.03)
CEO Reputation Awareness	-0.09	(0.12)	-0.10	(0.12)	-0.01	(0.10)	-0.01	(0.10)
Contingent Compensation	-1.56	(2.65)	-0.84	(2.57)				
CEO Capability Reputation Leadership	3.50	(4.96)					-2.67	(2.52)
Contingent Compensation X CEO Capability Reputation Leadership	26.78	(15.12)						
CEO Capability Reputation SM			-2.30	(2.56)	3.20	(4.80)		
Contingent Compensation X CEO Capability Reputation SM			8.93	(8.18)				
Firm Capability Reputation SM					-7.40	(9.61)		
CEO Capability Reputation SM X Firm Capability Reputation SM					-46.80	(56.11)		
Firm Capability Reputation Leadership							2.81	(2.34)
CEO Capability Reputation Leadership X Firm Capability Reputation Leadership							1.64	(6.50)
R squared	0.94		0.94		0.93		0.93	

n=189

* p< 0.05; ** p< 0.01

DISCUSSION

This study was designed to determine the effect that CEO reputation has on the market's perception of the adverse selection of a newly appointed CEO. Theory into the perceptions of adverse selection as an extension of agency theory is in the early stages, both theoretically and empirically (Graffin, et al., 2012). This study involved extending what is known regarding the shareholders' reaction to the CEO selection process. An assumption of this research is that because limited information is available from the firm for shareholders regarding the CEO selection process, shareholders draw conclusions about the new CEO's suitability based on the information that is available, namely that which is present in the media. The reputation for the capabilities of leadership and effective strategic management of the CEO, theorized in recent work (Mishina et al, 2012), are operationalized in this work. Specifically, this research examines the relationship between the media based reputation of the newly appointed CEO for the year prior to the appointment announcement and the shareholders' reaction to the announcement of the new CEO.

Before discussing the findings of this research, it is noteworthy to discuss the measures of reputation used in this dissertation. This study involved the use of established operationalizations of reputation, such as reputational awareness and CEO compensation, and newly established methods to measure reputation, such as CEO reputation for a capability, firm reputation for a capability (the going-in-mandate) and CEO fit. While the established measures regarding the newly appointed CEO reputation have supported the effect CEO succession has on a firm, criticisms of this measure appear in the literature. Specifically, a criticism of reputational awareness is that as a count of the number of articles about a CEO or firm in the print media this measure does not communicate the characteristics of the reputation of the CEO or firm (Barnett, Jermier, & Lafferty, 2006). As such, many researchers contend that reputational awareness is an antecedent to reputation (Brooks, Highhouse, Russell, & Moh, 2003; Turban, 2001). Researchers' use of CEO compensation as a signal of reputation faces several criticisms including how compensation is measured in empirical studies (Finkelstein et al., 2009) and the use of CEO compensation, which is influenced by social and institutional factors in addition to market conditions, as a valid proxy for other measures such as reputation (Allgood et al., 2012). Similar criticisms of the extant CEO succession measures observe that the constructs lack validity as proxies for other measures (Pitcher et al., 2001). Thus, research on CEO succession has called for more detailed information regarding the CEO successor's qualifications (Pitcher et al., 2001) and has identified the need to quantify the going-in-mandate (Quigley & Hambrick, 2012).

The newly established measures for reputation in this dissertation include CEO reputation for a capability, firm reputation for a capability (the going-in-mandate), and CEO fit. These measures are all theoretically based in the agency theory assumption that information asymmetry exists for the shareholders in determining the CEO qualifications for the role of CEO and the potential for a newly appointed CEO to be an adverse selection. Specifically, this dissertation examines these constructs with respect to leadership and effective strategic management, which are important situation specific measures for this context of CEO selection. Although empirical work has been done to examine the reputation of the moral hazard aspects of agency theory (Philippe & Durand, 2011), this is the first empirical examination of the reputation for the capability theorized by Mishina and colleagues (2012). The CEO fit has been previously empirically examined, but in a significantly different context (Chen & Hambrick, 2012). The going-in-mandate has yet to be examined empirically (Finkelstein et al., 2009); this research measures the shareholders' perception of a going-in-mandate. The use of the Janis-Fadner coefficient of imbalance is commonly used for content analysis and was used in the empirical examination of the moral hazard of agency theory (Philippe & Durand, 2011). Although there is a high level of reliability of these measures presented in the methods section, there could be some question as to the validity of these constructs. Although all measures appear to valid (face validity), the ability to replicate these results and whether these measures capture the shareholders perception of the CEO, firm, and the fit of the CEO to the needs of the firm may call into question the validity of these measures.

Prior research has found that shareholders focus on the media representation of the situation, rather than the firm's press releases (Bednar, 2012; Dyck & Zingales, 2002; Miller, 2006) and that shareholders make determinations concerning firms through the information disseminated by reputable, large-circulation media sources (Bednar, Boivie, & Prince, 2013; Lee & James, 2007). However, the concept of reputation in media has changes in recent years, to argue that the reputation of the CEO and firm may be validly determined from print media sources in today's media world of television, radio, and social media may be short sighted. This is especially true for the CEO selection process, where many CEOs have minor celebrity and may have significant information presented in the non-print media that may influence the reputation of their capabilities.

The results of this dissertation research show limited support for the hypothesized relationships that the reputations of the CEO and hiring firm influence the shareholders' perception of adverse selection of a new CEO. The hypotheses that found support were limited to those dealing with the CEO reputation for the capability of leadership. As stated in hypothesis 2, lower levels of CEO reputation of leadership capability lead to higher levels of perceived adverse selection. This is readily apparent when considering that shareholders believe that leadership is integral to the success of an organization (Waldman, Ramírez, House, & Puranam. 2001). Shareholders have a romance with CEO leadership; the reputation for this capability may be the most readily accepted by the shareholders of any reputation for a capability.

When contingent compensation was used to moderate this relationship between CEO reputation for the capability of leadership and the perceived adverse selection as is seen in hypothesis 5a, the moderation illustrates that compensation structure does indeed play a role in the perception of adverse selection. Figure 2 provides a graphical representation of this interaction. With lower levels of CEO reputation for the capability of leadership, the proportion of contingent compensation has little effect on the differences in the market reaction; however, as the CEO reputation for the capability of leadership increases, the proportion of contingent compensation has a larger and positive effect on the influence on the CEO successor's reputation and the market reaction to the new CEO succession. This illustrates the perception that shareholders have about the compensation structure of the CEO, namely that contingent compensation is motivating for the CEO and serves to align goals.

Overall, I expected the results to show a strong relationship between reputations-based independent variables and the perception of adverse selection. Theory suggests that shareholders assess the firm's new CEO announcement based on information available in the media (Graffin et al., 2012). Thus, it is reasonable to expect shareholders to assess the capabilities of a CEO through the reputation of the CEO presented in the media prior to the succession event. For instance, shareholders find a favorable selection when the CEO appears in the media to have the ability to meet the needs of the firm; in contrast, an adverse selection determination by shareholders is an instance in which the CEO appears to lack the ability to meet the needs of the firm.

Although I will examine the theory surrounding each unsupported hypothesis, I would like to first examine several overarching factors that may have led to non-significant findings in this dissertation. A basic assumption of these agency theory based arguments made within this dissertation is that the BoD does not transparently present information to shareholders regarding the CEO selection process; this lack of transparency creates an information asymmetry problem for the shareholders. However, the shareholders may trust the BoD. The shareholders lack of exact details of the CEO selection process may not create a problem for them. Although much criticism has been noted in this dissertation about the BoD's ability and motivation to select a favorable successor, the BoDs for all firms are not universally considered incompetent and self-interested. Thus, a basic premise of this research may be flawed if the shareholders chosen in this sample believe their BoDs are effective fiduciaries.

Rather than presenting the CEO and firm reputations as signals that mitigate some of the information asymmetry that is presented in agency theory, it may be more appropriate to consider the reputation for a capability as a resource (or lacking a resource) that may create competitive advantage or to position these reputations in the framework of signaling theory. Shareholders, as the receivers of the signals, have their perceptions influenced by the perceived honesty of the signaler, the frequency of the signal, and the signal fit (the extent to which the signal or public information is related to the unobservable or private information). Signaling theory may be used to exam the different signals that may minimize information asymmetry, such as directly testing both press releases and print media to determine which source has more legitimacy for shareholders. This theory can also be used to examine the frequency and fit of the signals. For example, the frequency of information in the media regarding the CEO in the year prior to the CEO may create a higher variance in the shareholder's reaction the announcement. Also, the fit of the press releases and print media to analysts' recommendations, given that analysts may have access to private information, may also influence the shareholders' reaction to the new CEO announcement. In either context, the premise of the information asymmetry need not hold for the theory to be valid in this CEO selection process context.

Research is clear that shareholders gather information from print media to make determinations about CEOs and firms (Bednar, Boivie, & Prince, 2013), and that shareholders have a similar reaction to the information in the market; there are several underlying assumptions to this premise. First, an assumption is that differences in the composition (e.g., transient versus dedicated) of shareholders from firm to firm does not affect the shareholders' market reaction to information. It is possible that the transient owners who take a short term approach to stock ownership may be significantly more likely to sell immediately following the new CEO announcement, since there is a great deal of uncertainty associated with the succession of a CEO. Second, it is understood that all shareholders gain information from the same print media sources. However, the some shareholders may gain information regarding the selection process through word of mouth in an industry or institutional shareholders may have information regarding the CEO selection process through a board member the institutional shareholder appointed to the board. Additionally, shareholders could use television, radio, or social media to gather information. Third, there is an assumption that all shareholders gain information at the same time. A concentration of ownership may mean more communication between the BoD and the shareholders, leading to knowledge of the CEO chosen as the successor prior to the announcement. Or a shareholder with a network of contacts may have information on the short list of candidates for CEO weeks prior to an announcement, limiting the amount of new information in the market at the time of the announcement. Thus, the process through which shareholders gain information and the timing of receiving information may be heavily dependent on the shareholders' network. Future research could build on work in structural and relational embeddedness (Moran, 2005) to determine if the shareholders' network structure or the closeness and relational trust more strongly influences the shareholders' market reaction to the new CEO appointment announcement. Additionally, it is understood that all shareholders are rational in their reaction to the information that they gain from the market. And lastly, it is assumed that all shareholders believe that the print media is unbiased. If any of these assumptions fail to hold true, then the use of print media in content analysis for this research would come under question.

Although the two supported hypotheses show promise for the future of this research, the lack of robust findings encourage the re-examination of the theory and methodology regarding seven of the hypotheses that fail to find support. The following represents a discussion of the theoretical issues and alternative theories that could explain the lack of findings for seven hypotheses. The methodological issues are discussed in the limitations section following the discussion.

Although hypothesis 1 is theorized that the more news articles in the media leads to a positive market reaction, there may be an alternative explanation. The market may have a stronger reaction to the more information that is available about the newly appointed CEO. Thus, the CEO with a larger number of articles that positively frame his or her reputation may have a positive market reaction, whereas a CEO with a larger number of articles that negatively frame his or her reputation may have a negative market reaction to the appointment announcement. Thus, the argument could be made that the higher the reputational awareness, the larger the variance in the market reaction to the new CEO appointment.

The non-supported hypothesis relating to the CEO reputation for a capability of effective strategic management (H3) and the going-in-mandates or the firm reputation for a lack of a capability for leadership (H4a) and effective strategic management (H4b) have similar premises. The hypotheses state that CEO and firm reputation for a capability will affect the shareholders' perception of adverse selection following the CEO announcement. The logic is rational; however, a lack of support is disappointing. An argument could be made that a capability for effective strategic management is not as easily definable by the shareholders as leadership so it is difficult for the shareholder to identify in the print media this capability as a reputation. Additionally, the reliability of the strategic management quantitative content analysis variables, for which the IRR between rater and LIWC program is 0.76, could have created noise in the results. Since the going-in-mandate of the CEO for the firm is usually not disclosed by the BoD, it may be unrealistic to assume that the concept of a going-in-mandate is considered by the shareholders when evaluating the CEO's adverse or favorable selection at the time of the announcement.

The logic of the hypotheses in which contingent compensation serves as a moderator between the reputation for the capability of leadership (H5a) and effective strategic management (H5b) and the shareholders perception of adverse selection are similar. Although there does appear to be a theoretical reason for the lack of significance for H5b when there are findings for H5a. The shareholder's reaction could be negatively influenced by the perceptions regarding motivation that CEO contingent compensation elicits. For example, a favorable CEO selection may face a problem of moral hazard because of the motivation to take higher risks. In the cast of effective strategic management, the newly appointed CEO may have the necessary capability of strategic management, but also may have motivation because of a compensation structure to act in a way that is contrary to the shareholders desires.

H6a and H6b which examine the CEO fit remain unsupported as well. This lack of support may have some theoretical basis. The foundational work in CEO fit (Chen & Hambrick, 2012) examined the degree of misfit of the past CEO within the context of the firm and the CEO selection, rather than the CEOs fit to the going-in-mandate. They find that the extent of mis-fit of the past CEO and the fit of the new CEO to the context of the firm determine the fit of the new CEO. This is a substantially different argument than that which is theoretically presented throughout the CEO selection literature (Finkelstein et al., 2009). This work by Chen and Hambrick (2012) may signal the lack of practical application of the going-in-mandate. Since the going-in-mandate is not disclosed by the BoD and is difficult to enumerate, other measures of the firms needs may better serve researchers in determining the shareholders perceptions of adverse selection than the going-in-mandate. For example, the CEO's reputation for the capability of managing an organizational turnaound, of managing a media crisis, or of managing the firm in a hypercompetitive industry may all serve particular contexts a firm may experience and therefore shape shareholders' perception of adverse selection.

Limitations

The limitations of this study present tradeoffs in the design of the study. For example, the use of event study methodology provides a unique opportunity to examine the perception of adverse selection, where a measure of adverse selection is unavailable; however, the event methodology present limitations to the study. Additionally, the sample of CEOs who have prior experience in the role of CEO at a publically traded firm on their resumes, presents an opportunity to examine seemly qualified CEOs, who as external successors have a high level of information asymmetry between the CEO and the BoD. However, this unique sample limits the sample size and creates a sample that has measurements that may have changed over the 20 year sample time frame. Thus maturation may diminish the validity of certain measures. For example, compensation structure of the CEO has changed over the time frame of this sample, such as the changes in the use of options and overall increased size of compensation (Devers et al., 2007).

The event study methodology suffers from several key criticisms. Event studies, even when all criteria for a successful study are met (adequate volume, appropriate window, controlling for confounding effects, etc.), are faced with a fundamental problem. Event studies are based on the idea that information is released into the market in small, incremental amounts (Black & Sholes, 1973; Fama, 1965). However, there is evidence that the release of and reaction to information is to some respect a predictable rather than a random pattern (Cox & Ross, 1976) and that this release of information may be part of a larger cluster of information released that is not independent. Thus, the established event window may not work to capture information for every firm or time period.

Event studies present another unique problem for researchers. Researchers try to limit potentially confounding effects in event studies, but due to the nature of the sample of this study it is impossible to control for the non-print media factors that influence the reputation of newly appointed CEO. The announcement of a new CEO occurs in the print media, but simultaneously may occur on the television, on the radio, through word of mouth, and in social media. It is possible that print media may release different information regarding the CEO selection in a different timeframe than the other sources of information. How then does a researcher control for the confounding effect of the non-print media on this research? By limiting the sample to print media in major journals, I may have eliminated information about firm and CEO that could be deciding factors in the reputation for the capabilities of the CEO and firm. Unfortunately, this is a potentially serious limiting factor which methodological considerations for media attention have not yet overcome; research-to-date has not yet solved this problem in a way that creates valid measures (Doorley & Garcia, 2007).

Additionally, as I was unable to compile exact information on the qualification of the CEO, I used measures for the reputation of a capability that were collected through LIWC, a content analysis program. Although the reliability between the raters for these newly developed constructs that use content analysis is high, with all above 0.90, the reliability between the content analysis program (LIWC) and rater is not consistently high. The reputation for the capability for leadership has a reliability of 0.93; however, the reputation for the capability of effective strategic management has a lower IRR of 0.76 between rater 1 and the LIWC computer program. There are criticisms regarding the use of content analysis that have foundations in the reliability and validity of the content analysis measures. Content analysis may not accurately capture all the intended content every time, as was found here in the IRR of 0.76. I believe that the rater is accurate; the IRR of 0.73 alludes to the inaccurate conversion of qualitative reputation of a capability for effective strategic management to a quantitative number by the LIWC program.

Furthermore, I chose to operationalize the going-in-mandate as the needs of the firm that are expressed in the media. Limiting this operationalization to firm level content is consistent with prior research's theorized going-in-mandate (Finkelstein et al., 2009), but limits the prior CEO's potential deficiencies that influence CEO selection process and the shareholders' perceptions of a successful CEO selection. These CEO deficiencies have in research been linked to the determination of a succession CEO succession choice (Chen & Hambrick, 2012). By not including the prior CEO's lack of capabilities for leadership and effective strategic management, I limit the ability to incorporate the additional factors that my shape shareholders' perceptions.

Significant attempts were made to reduce the limitations of this study, including controlling for confounding events, creation of an instrumental variable to minimize endogeneity, the use of established constructs, and the careful crafting of a number of newly developed constructs. Despite careful methodological considerations, I have identified here the potential for several key limitations to the research design of this study.

Future Research

This dissertation may serve as a foundation for future research in numerous ways. First, although the findings in this research are limited, the findings provide some support to the CEO reputation as a factor in determining the shareholders' perception of adverse selection. Continued examination of the effects that reputation has on the CEO succession process may include how reputation of the new CEO affects organizational change, the success of implementing change and the reactions of other members of the TMT to the CEO selection. The reputation of the prior CEO may influence who is chosen as a new CEO, how the selection process proceeds, and when the CEO selection process will take place. Specifically, it would be interesting to examine if a CEO with reputation for the capability for leadership assists the BoD with succession planning when he retires.

Although adverse selection is difficult to quantify; however, the perception of adverse selection allows a researcher to examine a quantifiable dependent variable while examining information asymmetry. Additional work should be done to continue to examine the perception of adverse selection within the agency theory framework. Research questions to advance this area should build on research that has successfully tested the CEOs fit (Chen & Hambrick, 2012). Specifically, research on perceptions of adverse selection should incorporate the context of the firm, such as bankruptcy and more established measures of the firm's prior CEO such as tenure and demographic information.

Additional theoretical questions should also be considered to advance the use of reputation in understanding agency theory threats. This dissertation addressed the CEO's reputation of a capability. However, Mishina and colleagues (2012) present a way to quantify the antecedents to both agency threats, adverse selection through a reputation for a capability and moral hazard as a reputation for a character. Both of these diminish uncertainty and information asymmetry. The challenge in addressing questions associated with moral hazard and adverse selection has been how to quantify the morality or motivation and the qualifications of the CEO. The reputation for the capability or character solves that measurement issue.

These constructs of a reputation for a capability should also be examined outside the agency theory literature to consider how the CEO's reputation for a capability may affect the successful implementation of strategic change and gaining competitive advantage. For example, does a CEO with a reputation for the capability regarding alliance management have more success with alliances in terms of patents, number of alliances, or length of alliances? Do CEOs with a reputation for the capability of leadership produce a greater change in successfully executing performance turnaround?

The going-in-mandate the BoD develops for the CEO is relatively untested empirically. The development of a quantitative measure for the going-in-mandate must continue to be pursued. Although this dissertation failed to find support for hypotheses including a going-in-mandate and CEO fit based on reputation measures, these areas are still worth future pursuit. The going-in-mandate is theorized as a mandate for change from the BoD to the CEO; however, this premise has not been investigated. Could there be times in which the BoD hires a new CEO, but requests the CEO to maintain the status quo within the firm because the firm has been profitable? This question as well as others presented herein would provide interesting areas for future research for scholars seeking to know more about CEO reputation, adverse selection within agency theory or the CEO selection process.

CONCLUSION

This dissertation had several goals. The first was to gain insight into the market reactions to CEO selection announcements, specifically the reaction to the announcements of those newly-appointed, seemingly-qualified CEOs that have prior CEO experience. Additionally, I sought to examine the signals that influence the shareholders' perception of adverse selection and contribute to the literature on reputation's effect on the perception of adverse selection. To investigate the effect the CEO's reputation has on the shareholders' perception of adverse selection it was necessary to develop a construct of CEO reputation for a capability of leadership and effective strategic management and the shareholders' perception of the going-in-mandate for the CEO. Furthermore, I pursued research that incorporated compensation as a signal of the information asymmetry between CEO and BoD. And I operationalized and CEO fit in the context of the CEO selection process.

Although this research found limited empirical support, I hope this dissertation fills a gap by empirically demonstrating that CEO reputation may influence the market's perception of the quality of the new CEO. This research found that the CEO reputation for the capability for leadership does influence the shareholders' perception of adverse selection; namely that CEOs with negative reputations regarding leadership are associated with a lower market reaction following the new CEO announcement than those CEOs with a higher reputation for that capability. Additionally, I hope this research encourages future research incorporating other signals that may minimize the information asymmetry on the topic of the CEO selection process. This research found support for the hypothesized relationship that compensation structure can be useful in limiting information asymmetry as a moderator between the reputation of the CEO for the capability for leadership and the shareholders' reaction to the new CEO announcement. In conclusion, the two supported hypotheses in this research provide a foundation for continued research into agency theory's assumption of informational asymmetry

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