

The Market for CEOs

Peter Cziraki

University of Toronto

Dirk Jenter

LSE & CEPR



Economics

UNIVERSITY OF TORONTO



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

CEO-firm matching

- Empirical evidence: CEOs matter for firm performance
 - Suggests that efficient CEO-firm matching is important
- ⇒ **What model best describes this matching process?**
- Models of perfectly competitive & frictionless matching
 - Tervio (2008), Gabaix & Landier (2008)
 - If skill & firm size complementary ⇒ explanation for rise in pay
- Increased demand for general managerial skills
 - Murphy & Zabojnik (2004, 2007), Frydman (2019), Custodio, Ferreira & Matos (2013)
 - Skills become more transferrable ⇒ explanation for rise in pay

This study

- Compare CEO hiring patterns to predictions from these (and other) models
 - Prior connections to the hiring firm
 - Whether raided from another firm
 - Differences in hiring choices across firms
 - New CEO pay
- All new CEOs in the **S&P 500** from 1993-2012
 - Fewer frictions
 - Require CEOs with general skills
 - ⇒ Closest to the competitive and frictionless ideal

Results

- Most new CEOs have prior connections to the firm
 - **80.4%** of new CEOs are insiders
 - Larger firms – even more internal promotions, fewer outsiders
 - **10.6%** of new CEOs are co-workers of directors
 - ⇒ **>90%** of new CEOs are insiders or co-workers of directors
- Sources of outsider hires:
 - 3.2% of new CEOs raided from CEO positions at other firms
 - Below-CEO executives at other firms (55%), unattached (31%)
- Differences in new CEO pay:
 - Outsiders are more expensive than internal promotions
 - But: Differences small as % of firm value (<\$2m p.a.)

Interpretation & implications

- Market not well described by models in which all skills are general and all firms choose from one unified pool
- To match the data: Firm-specific human capital or asymmetric information
 - Both predict a preference for insiders
 - ASIF needed to explain hiring of “connected outsiders”
 - Directors want to know the candidate (or vice versa)
- Alternatively, boards may not be doing the right thing
 - Agency problems
 - Behavioral biases

Insiders vs. outsiders

All firms (1,256 CEO hires)

Internal promotion	External hire
72%	28%

1993-1999 (418 CEO hires)

Internal promotion	External insider	Outsider
74%	7.7%	18.7%

2000-2006 (515 CEO hires)

Internal promotion	External insider	Outsider
70%	9.3%	21.0%

2007-2012 (323 CEO hires)

Internal promotion	External insider	Outsider
74%	7.7%	18.6%

Outsiders' connections

Connections between boards and new CEO hires

	Outsider hires		Hired elsewhere	
	Number	%	Number	%
Board connection	66	54	4	3
No board connection	57	46	119	97
Total	123		123	

- ❖ More than 90% of new CEOs are from the firms' current or former execs, board members, or co-workers of its directors

Sources of outsiders

Outsiders (246 hires)

All outsiders		19.6%		
		Raided CEO	Raided other executive	Unattached manager
As a % of all hires:		2.8%	10.7%	6.1%

External insiders (106 hires)

All external insiders		8.4%		
		Raided CEO	Raided other executive	Unattached manager
As a % of all hires:		0.4%	1.4%	6.5%

❖ Only 3.2% of hires are raided from CEO positions at other firms

Origin firms of raided hires

	Raided other executives		Raided CEOs	
	N	%	N	%
Type of origin firm				
US public	119	77.8%	32	80.0%
US private	28	18.3%	6	15.0%
Foreign public	6	3.9%	1	2.5%
Foreign private	0	0.0%	1	2.5%
Observations	153		40	
	Mean	Median	Mean	Median
Market value	115,033	60,521	10,396	5,240
Book assets	73,607	30,720	7,752	4,718
12m ind.-adj. return	0.55	-0.01	-0.40	0.13
36m ind.-adj. return	0.36	0.09	-0.13	0.10
ROA	0.06	0.05	0.01	0.04
Ratio (origin/destination) firm:				
Market value	11.54	4.34	0.38	0.28
Book assets	12.90	4.23	0.31	0.24

Hiring firms

By source of outsider hire

	Raided CEO		Raided other executive		Unattached manager	
	Mean	Median	Mean	Median	Mean	Median
Market value	27,189	17,289	17,478	9,219	10,799	7,304
Book assets	25,974	16,005	10,891	6,153	7,680	5,077
12m ind.-adj. return	-0.53	0.03	-1.14	-0.14	-1.26	-1.32
36m ind.-adj. return	-0.26	-0.20	-0.41	-0.40	-0.40	-0.60
ROA	0.03	0.03	0.05	0.05	0.04	0.03

New CEO pay

By insider vs. outsider

	Internal promotion		External insider		Outsider	
	Mean	Median	Mean	Median	Mean	Median
Abnormal pay - partial year	49	-560	3,496	931	5,258	4,279
Abnormal pay - first full year	12	-402	1,462	1,475	1,544	541

By source of outsider hire

	Raider CEO		Raider other executive		Unattached manager	
	Mean	Median	Mean	Median	Mean	Median
Abnormal pay - partial year	4,258	2,969	6,071	5,342	4,395	3,649
Abnormal pay - first full year	1,321	795	1,475	507	1,764	512

Conclusions

- Firms hire CEOs they are already familiar with
- There is little reallocation of CEOs across firms

⇒ Suggests:

- Firm-specific human capital & personal contacts are of first-order importance
- The effective hiring pool differs across firms and is small
- Maybe: rising CEO pay explained by CEOs sharing increasing match-specific rents?