# Does CEO turnover matter in China? Evidence from the stock markets

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As CEO decisions exert an impact on firm performance, we can expect that CEO change will affect stock prices. Nevertheless, the literature does not provide clear conclusion on stock market reaction to such events, as some studies conclude to positive reaction (Huson, Parrino and Starks, 2001) while others find negative reaction (Dedman and Lin, 2002) or no significant reaction (Warner, Watts and Wruck, 1988). Furthermore all these studies focus on developed countries and no evidence exists on the consequences of CEO changes in China.

The aim of this paper is to fill this loophole in the literature by analyzing the stock market reaction to the announcement of a CEO change in China. This issue has major implications for China. From a stockholder perspective, we provide information on how managerial replacement influences the pattern of stock value evolution. From a regulator perspective, we bring information on the effectiveness of internal and external forces within Chinese firms.

China is characterized by the fact that most listed firms are still majority-owned by the State. This presence of the State in the ownership of firms can then exert an impact on how stock markets react to CEO changes, as manager objectives differ between state-owned firms and privately-owned firms. In Chinese state-owned firms, the board of directors rubber-stamps CEO change decisions made by the state controlling shareholder (Kato and Long, 2006). The incoming manager is thus expected to act in line with the state controlling shareholder objectives. Consequences of CEO changes might then differ between state-owned enterprises and private owned enterprises as the objectives of managers differ.

Theoretical literature provides two categories of hypotheses on the stock market reaction to CEO turnover. The first category predicts no abnormal returns around CEO change announcement following the scapegoat hypothesis. Dismissal would be a threat that guarantees CEO efforts, and the effective dismissal is necessary to preserve the credibility of this threat. The new CEO is not expected to be a better manager. The second category predicts abnormal stock returns around CEO turnover announcement. It contains the information hypothesis, which predicts negative stock market reaction around CEO change announcements because it reveals unsound management choices, and the ability hypothesis, which predicts positive stock market reaction because the new CEO is expected to be a better manager.

If CEOs in state owned enterprises follow government's objectives, a CEO dismissal might not be due to a higher expected ability of the incoming CEO but as a threat in case of very poor firm performance. Chang and Wong (2009) suggest that state controlling shareholder only dismiss a CEO when poor performance becomes a burden for the state. We then assume that the scapegoat hypothesis applies to CEO changes in state-owned enterprises. We hypothesize that, because CEO in private-owned enterprises are supposed to maximize stock value, the scapegoat hypothesis does not apply to CEO changes in private-owned enterprises.

We apply the event study methodology to assess the impact of CEO change announcements on the stock price of a firm. We use a large sample of 1172 CEO change announcements on the Chinese stock markets over the period 2002-2009. We identify General Managers (*zongjinli*) as CEO in Chinese listed firms. We perform regressions of cumulative abnormal returns on firm variables to test the different hypotheses. We notably investigate the role of forced and voluntary CEO changes, and of insider and outsider successions.