EXECUTIVE TRANSITIONS, FIRM PERFORMANCE, ORGANIZATIONAL SURVIVAL AND THE NATURE OF THE PRINCIPAL-AGENT CONTRACT *

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Abstract _____

Using an agency framework, this study examines how executive transitions very according to the nature of the relationship between agent and principal, firm performance, and the executive's relative power. Using the entire population of Spanish newspapers during the period 1966-1993, we find that declining performance is a precursor of executive changes, but that the impact is much greater for the second person in command. This suggests that entrenchment allows the top executive to be relatively insulated from firm performance, yet hold his/her subordinate accountable for that performance. We also find, contrary to an "scapegoat" or population ecology prediction, that executive changes have a positive impact on firm survival, and that the salutary organizational effect of managerial transitions is greatest for the top executive.

Key Words

Executive transitions, Performance, Entrenchment.

Neoclassical economic theory focused on the entrepreneur as the decision maker for the firm. The interests of this individual were assumed to be isomorphic with those of the business, thus that his/her decisions were driven by the desire to maximize firm performance subject to market constraints. While this simplifying assumption made it possible to develop elegant economic models leading to deterministic predictions based on the concept of equilibrium (for instance, the product price would be set at a point where it equals marginal revenue product), it limited our understanding of the behavior of hired managers whose interests may not be synonymous with those of the firm's owner. Starting with early works by Berle and Means (1932) and Coase (1937), the theory of agency emerged to fill this gap in neoclassical economics by focusing on those situations that involve delegation of duties to an individual (agent) who is expected to act in the best interest of the party (principal) paying for the agent's services.

Any agency relationship raises the possibility of opportunistic actions on the part of the agent; the agent may have different objectives than the principal and thus be tempted to pursue his or her own self-serving agenda. In the parlance of agency theory, agents are tempted by a "moral hazard" that may lead them to take advantage of the principal. This is more likely to occur when the tasks performed by the agent on behalf of the principal are "nonprogrammable" (i.e., difficult to structure) and "information intensive" (i.e., require highly specialized skills and knowledge to carry them out). Nonprogrammability and information asymmetries give the agents more autonomy and discretion, which they may use to pursue their own ends (Gomez-Mejia & Balkin, 1992).

The appointment of managers by firm owners to run the business represents a prototypical case of such a relationship. First, it is not feasible for absentee owners to structure and closely supervise the activities of top executives. Second, executives as agents know far more about organizational processes and the appropriateness of business decisions than absentee owners so that information asymmetries are likely to be present between the parties. Lastly, executives are in a position to utilize organizational resources to pursue

1

objectives that may not be compatible with the best interest of owners (e.g., entrench themselves so that they can't be easily removed when firm performance is poor).

In other words, the principal may incur some losses whenever the agent pursues objectives that are incongruent with those of the principal. These agency costs may go undetected to the extent that information asymmetries are present (i.e., the agent has more knowledge about the task at hand than the principal) and it is difficult for the principal to program and observe the agent's actions. In the jargon of agency theory, moral hazard tempts agents to take advantage of their privileged position, producing agency costs for the principal.

These agency costs may be reduced in two ways: (a) the establishment of incentives that reward the agent for outcomes of importance to principals such as profitability (generally referred to as "incentive alignment" for short) and (b) the development of a system for monitoring the behavior and decisions of agents to ensure that these don't deviate from the interest of owners.

Most of the conceptual and empirical literature on agency theory has been circumscribed to incentive alignment, that is, the use of financial rewards as a mechanism to maximize the joint utility curves of the agent and principal so that their interests become intertwined. The rationale for this emphasis has been that in the absence of good information about the activities or behaviors of the agent, incentive alignment becomes the most viable control mechanism to reduce agency costs (Eisenhardt, 1989). Because it is difficult if not impossible to effectively monitor executive's behavior and decisions, given nonprogrammability of tasks and extensive information asymmetries, principals must rely on incentive alignment so that rewards linked to performance outcomes engender "self-monitoring" on the part of the executive.

Following the above logic, more than 300 empirical studies have examined the relationship between executive pay and firm performance (Gomez-Mejia, 1994). As a whole, this literature shows that, at best, incentive alignment is a weak mechanism of control for top executives. Typically the percent of variance in executive pay attributed to firm performance is under 10% and seldom exceeds 15%. A recent meta analysis of executive compensation studies published during the last fifty years by Tosi, Werner, Katz, and Gomez-Mejia (1996)

found that firm performance and changes in firm performance explain 5% and 4% of the variation of CEO compensation and CEO pay adjustments, respectively.

Given the weak results for incentive alignment, this leaves open the possibility that monitoring may play an important role as a control mechanism. One way to test this notion is to ascertain if firm performance is a precursor to executive turnover. While minuscule in comparison to the large number of studies on incentive alignment, the literature appears to support this linkage. It suggests that top management turnover generally follows periods of poor organizational performance (e.g., Friedman & Singh, 1989; Coughlan & Schmidt, 1985; Weisbach, 1988) even though "the magnitude of this performance/turnover relationship is not always strong" (Walsh &Seward, 1990).

This paper empirically addresses several important issues that are still poorly understood on the causes and consequences of managerial exits in relation to firm performance. First, little is known about how interpersonal relations or the presence of a psychological contract (vis-à-vis a more formal contract) between agent and principal influences the employment security of the agent when firm performance declines. Second, the literature on the organizational consequences of executive terminations has provided mixed results, so that we still have much to learn as to whether or not dismissal of the agent is beneficial to the firm (Haveman, 1993). Third, little is known about the cumulative effects of executive changes overtime on organizational survival. Lastly, while there is an extensive literature on executive entrenchment to neutralize monitoring mechanisms, the extent to which agent entrenchment increases as the probability of organizational failure increases remains to be examined (Walsh & Seward, 1990). Each of these issues will be discussed next, leading to a set of hypotheses to be tested empirically on the entire population of Spanish newspapers during the period 1966-1993.

Monitoring, Relational Properties, and Agent Sanctions

An issue that has received little attention in the agency literature but that is especially relevant to monitoring and its consequences concerns the existence of a "relational contract" (MacNeil, 1978) between the agent and the principals. Relational contracts differ from

traditional economic transactions in several ways. First, interaction between agent and principal creates utility for the relationship itself that goes beyond the exchange value of the transaction. Second, experience in the contractual relationship creates mutual expectations for future interaction such that both parties tend to view the horizon of the relationship as indefinite and thus increase their commitment to relationship. Third, experience and the indefinite horizon enhances mutual trust. The development of trust promotes compromise and resolution over disagreements about performance that may result from unforeseen circumstances. The principal willingly delays complete specification of performance for the agent and judge compliance in the light of circumstances at that times. That is, what is to be done, how and when is less precisely specified and often changes over the life of the contract with changes in conditions. In normal economic contracting arrangements, assumptions of self-interest dictate that performance be precisely specified at the time of negotiation and is subsequently judged exclusively against that criteria. Research by Zaheer and Venkatraman (1995) support the role of trust in economic relations. In their examination of the governance structure between insurance agents and commercial clients, they found that trust explained the structural form of the inter-organizational relationship even after controlling for economic factors.

The presence of *relational governance* properties (such as trust) in economic exchanges adds another element to principal-agent contracts that a focus on economic aspects alone may miss (Granovetter, 1985; Buckholtz, Schulze, & Dino, 1996). An analogous concept in the organizational behavior literature is that of the psychological contract (Tosi, Rizzo, & Carroll, 1996), referring to an underlying non-formal agreement regulating the behavior of two parties to a relationship, which creates a common bond and a set of mutual expectations.

Close interpersonal interactions between agents and principal would seem to encourage the development of *relational governance* elements. As a result, both parties may attach value to the "relationship" that goes beyond the purely economic value created by transaction. These factors may influence the longevity of the contract (agents may be allowed

to stay beyond their useful contribution to the organization), as well as insulate the agent from negative performance attributions in spite of poor organizational outcomes.

In other words, a relational contract between the agent and the principal relaxes the need for clear performance criteria and increases the expectation that evaluation of performance will be "fair" and reflect the changing conditions surrounding the contract. Thus, the presence of relational governance may also influence specification and enforcement of contract completion such that assessment of performance under relational norms implicitly recognizes extenuating circumstances arising between the time of contract negotiation and completion, and may even alter the definition of performance *ex post* in the light of those circumstances. Acknowledging the existence of relational governance provides an explanation for the inconsistent intertemporal association between firm performance and agent tenure. Thus:

> **Hypothesis 1:** The greater the relational properties of principal-agent controls the less likely that agents will be dismissed in response to negative performance results.

Agent Dismissal and Performance Consequences

The question of whether or not managerial succession affects firm performance "continues to intrigue organizational scholars because the empirical findings are inconsistent" (Haveman, 1993: 864). Carroll (1984) found that the dismissal of newspapers' editors augmented the mortality rates of these firms. In a separate industry, Singh, House and Tucker (1986) found the opposite results, revealing that the survival rates of voluntary service organizations improved in response to CEO successions. More recently, using a sample of small telephone companies in Southeasten Iowa at the beginning of the century, Havenman (1993) corroborated Carroll's findings in that succession precipitated organizational mortality. Haveman (1993: 867) concluded that "clearly, the limited and conflicting evidence researchers have to date suggests that the relations between managerial succession and organizational mortality needs further investigation".

At a conceptual level, we also find inconsistent theoretical predictions of the impact of executive changes on subsequent mortality rates. Agency theory argues that senior managers

are dismissed when the board responsible to monitor their behavior has decided that they are incompetent or lag behind the skills and abilities of their counterparts in competing firms. In other words, agent dismissal is an integral part of internal monitoring mechanisms to discipline managers when firm performance is in jeopardy (Walsh & Seward, 1990). As James and Sorey (1981:16) argued in their discussion of managerial exit, "dismissal is the ultimate sanction which conditions their [manager's] behavior." Other things equal, by dismissing top managers who are deemed to be ineffective and replacing them with successors who presumably have more talent, organizational performance should improve.

An alternative prediction is that organizations make negative performance attibutions to top management even though observed firm performance outcomes may be the result of exogenous forces that may be unrelated to managerial competence. In other words, executives are used as scapegoats, and changes at the top are largely ritualistic or symbolic to convey to employees and stockholders that poor performance will not be tolerated (Gamson & Scott, 1964; Brown, 1982). Therefore, if managerial sucession is merely a symbolic issue, dismissal should not affect firm performance.

A more extreme view is found among population ecologists who argue that managerial succession will diminish performance and increase the rate of failure, particularly for smaller organizations with fewer slack resources. According to population ecologists this is likely to happen for two reasons. First, changes at the top disrupts worker routines, creates uncertainty and confusion, interrupts chain of command, and decreases morale by making employees feel less secure (Allen, Pamian, & Lotz, 1979; Carroll, 1984; Gouldner, 1954). Grusky (1963) coined the label "the succession-crisis hypothesis" to denote a vicious circle whereby poor performance precipitates managerial dismissal which in turn accelerates performance decline and increases organizational mortality rates. Second, the departing managers take with them a great deal of knowledge about the firm and its external relations. This knowledge takes a long time to acquire by a replacement. As a result, dismissal and substitution of top executives provides a dysfunctional "liability-of-newness" (Amburgey, Kelly, & Barnett, 1993; Carroll, 1984; Freeman, Carroll, & Hannan, 1983; Singh et al., 1986). Haveman (1993: 867) summarizes this succession "liability" as follows:

New managers will bring with them new modes of action and new priorities that must be learned and routinized . In addition to changes in internal operations, managerial succession entails shifts in relations with a company's external environment. Top managers play important boundary spanning roles. Therefore, succession at the top disrupts external relations with suppliers, clients, and local communities. During the adjustment period that follows succession, organizational performance will be more variable and failure rates will be higher.

Given prior conflicting results, and inconsistent theoretical predictions, we will reexamine the effect of agent changes on organizational performance, measured in terms of subsequent mortality rates. The three theoretical predictions discussed above will be contrasted empirically:

Hypothesis 2a: Managerial succession will have a positive effect on organizational survival (agency prediction)

Hypothesis 2b: Managerial succession will have no effect on organizational survival (scapegoat prediction)

Hypothesis 2c: Managerial succession will increase organizational mortality (population ecology prediction).

Managerial Entrenchment

The literature on agency theory, particularly in the management field, recognizes that executives will try to neutralize internal control mechanisms to ensure self-preservation. This may result in executives holding their jobs past the point where their stay is beneficial to owners, a process called "entrenchment" which is another form of moral hazard (Fredrikson, Hambrick, & Baumrin, 1988; Herman, 1981; Kimberly & Zajac, 1988; Mace, 1971; Pfeffer, 1972; Vance, 1983). In a review of this literature, Walsh and Seward (1990: 430) conclude that:

Top managers are well aware of their precarious employment situations. Consistent with the evidence in the turnover literature, they know that they are at risk of being dismissed for sub-optimal performance...valuing their position, many executives work to ensure their own security. Toward that end, they have no choice but to tamper with the board's ability to monitor and control their performance.

Walsh and Seward (1990) discuss in great detail many agent entrenchment approaches, including among others, hiding or obscuring negative attributes, hiring consultants to

legitimize decisions, convincing the board to recognize the primacy of environmental determinism, manipulating or biasing information, and making themselves nonsubstitutable by embarking on a business strategy that capitalizes on their idiosyncratic skills and abilities.

If an increase in the probability of organizational failure augments the probability of executive dismissal (see hypothesis 1) this means that managerial entrenchment would tend to increase accordingly to prevent or delay termination. Therefore, as the probability of business failure increases, the tenure of the executive will decrease at a lower rate. In other words, managerial entrenchment will attenuate the strength of this relationship as employment insecurity rises. Similarly, following the arguments of hypothesis 1, when the ties between the executive and the firm are of a relational nature, the executive will have a greater likelihood of successfully engaging in managerial entrenchment practices. The next hypotheses follows from this logic:

Hypothesis 3a: The relationship between executive tenure and a firm's probability of death will be asymtotic, with the former decreasing at a lower rate than the latter.

Hypothesis 3b: The tenure of an executive under a relational contract will be higher regardless of a firm's probability of death.

METHODS

Research Setting and Data

The entire newspaper industry of Spain was used as the population of firms for the study, covering all the daily newspapers published in Spain during the period 1966-1993. The data base, consisting of 276 newspapers, was created by pulling information from three separate sources. The first source is the Registry of Newspapers ("Registro de Empresas Periodisticas"). This registry was legally mandated for all newspapers published in Spain, starting on March 18, 1966. It required extensive information on each publisher, including the title, the founders, number of pages, location, target audience, etc. The second source is the Newspaper Guide (Guia de Medios), which contains detailed demographic data on each firm, including when it was founded, when it ceased operations (if applicable), and the exact date for any succession event of the top executive or director. The last source is an ongoing report

produced by an independent newspaper association ("Oficina de Justificacion de la Difusion") which shows the total number of newspapers that are produced and sold by the firm.

These organizations differed substantially from the type of firms generally studied by agency scholars: Spanish newspapers are very different from large, modern, corporate U. S. based entities that are normally examined in the governance literature. The idiosyncracies of this population are valuable in assessing the generalizability of agency theory to examine the sensitivity of executive tenure to firm performance and the consequences of agent removal. Thus, a distinct advantage of the data base used here is its novelty by providing an opportunity to study principal-agent relations in a rather unique international context.

Operationalization of the variables

Organizational Age at the Time of Failure: The age of each newspaper was calculated as the difference between the founding date and the date it ceased to exist. If the firm continued to exist as of 1993, it was treated as censured data (see Carroll, 1984, for a discussion of this issue). This variable was used to test hypothesis 2 because it allowed us to examine the length of survival of the organization as a function of executive successions.

Performance: Financial earnings data was not available for the population of firms used in the study and very few of these firms were publicly traded. Therefore, we had to develop a proxy for performance based on the probability of failure. This was calculated as the ratio of the variance of volume of newspapers sold (circulation) divided by a term consisting of the average circulation minus the minimum circulation squared. To the extent that the average circulation for a given period exceeds the minimum circulation, the term in the denominator increases and the probability of failure decreases accordingly. The ratio was subjected to a logarithmic transformation since the distribution that best fit the data is lognormal in nature. This ratio was calculated separately for the period corresponding to the tenure of each executive.

Executive Tenure: This information was obtained for the top two executives. It measured the length of time transpired between date of hire and date of termination (if replaced) or 1993 (if still on the job) in which case it was treated as censured data (Lawless,

1982; Cox & Daves, 1984). The "gerente" (Chief Executive Officer, CEO) is almost always part of the extended family that owns the newspaper, or someone who is close to the family. This individual reports to the Board of Directors, and is responsible for all strategic and financial affairs of the business. The "director" (editor), on the other hand, is a professional journalist responsible for routine procedural matters, technical issues, implementation of the strategies traced by the CEO and the board (e.g., compliance with ideological orientation), content of the newspaper, and staff supervision.

These two executives were used as proxies to operationalize hypothesis 1. Because of the close ties of the CEO to the principal, the ongoing interaction between them, and the greater knowledge that the principal possesses about the agent, the control of the CEO by the principal would fall under the realm of a relational contract. The editor, however, is explicitly hired to perform a job for a fee and the information available about the character, motivation, and abilities of this individual is more limited than that available for the CEO. In the absence of better information, organizational performance attributions are more likely to be made to the behavior of the agent. In other words, the editor is more likely to be blamed for poor performance results. Therefore, following the logic of hypothesis 1, the relation between the editor and principal would tend to be confined to the exchange value of the transaction so that the director's tenure would be more closely tied to observed performance outcomes than the tenure of the "gerente" or top executive.

Managerial Succession: Two sets of dummy variables measured the exits of the CEO and the editor. We set each dummy variable equal to one during the period between the ith and (i + 1)th succession event and equal to zero otherwise. In addition, we calculated the total number of successions for the CEO and the editor during the entire period the newspaper was in business. Two sets of dummy variables were created to measure the effect of managerial succession on organizational survival, one set for the CEO and one for the editor. We coded each dummy variable as one if the firm has had ith successions and zero otherwise. As can be seen in Table 6 and discussed in the analysis section, we examined each succession separately up to four since this number encompasses the vast majority of exits per firm. At the same time, we created a dummy variable if the number of exits exceeded four. Lastly, we

created a discrete variable that measures the total number of succession events experienced by the firm. This total was subjected to a logarithmic transformation since the distribution that best fits the data is logarithmic in nature.

      Control variables: Several control variables were included in the study that may influence both the performance measure and mortality rates. A dummy variable controlled for sampling bias since 119 of the firms were born before the observation period began in 1966 (Cox & Oakes, 1984). If this was the case, the firm was coded as "1" and "0" otherwise. Competitive conditions was controlled with a variable for density (Singh et al., 1986) or the number of newspapers operating in a given year. If the newspaper owned the printing press used, it was coded as "1" and "0" otherwise. Capital structure was represented by a variable that equaled one if a firm issued stock to raise capital and zero otherwise (Haveman, 1993). Since Spain was under a totalitarian regime from 1939 to 1975 (under Generalisimo Francisco Franco), and some newspapers were subsidized by the state's political party ("El Movimiento"), a dummy variable was created to account for this with "1" designating party subsidy and "0" if the newspaper received no political funding. The age of the firm at the time of executive succession was also included in the equations to control for the liability of newness effect.

      Finally, we included a family tie control variable in the analysis concerning the editor's tenure. If the editor and the CEO are members of the same family, it was coded as "1" and "0" otherwise. This enabled us to partial out the newspaper performance effect on the tenure of the editor that may be attributed to this person's family relations with the immediate supervisor (i.e., CEO). To this end, an interaction term was created as "performance x family tie CEO-agent" and entered in the equation to predict editor tenure.

Analysis

      The hypotheses were tested using lifetime data models with right censored observations (Lawless, 1982: 31). For hypothesis 1, two models were calculated, one predicting tenure of the CEO and one predicting tenure of the editor. The independent variable in both cases was firm performance. The control variables are the ones described earlier, namely a dummy code for firms born before 1966, density, ownership of printing press,

11

capital structure, and party subsidy. In the editor equation, as noted above, a family tie measure was also included as a control variable as well as an interaction term "performance x family tie." A likelihood ratio statistics was calculated to determine if the coefficient for firm performance as an independent variable and agent tenure as a dependent variable was larger for the editor than for the CEO (which would support hypothesis 1 since this would indicate that tenure is more sensitive to firm performance for editors than CEOs).

Hypotheses 2a to 2c were tested by calculating two sets of models, one for the CEO and one for the editor. First, for each individual succession event as an independent variable, organizational survival up to the next succession event (if any) was used as a dependent variable. This indicates whether or not organizational failure occurred following each succession event. In a second set of models (one for the CEO and one for the editor), the total number of succession events during the life of the newspaper was entered as an independent variable and organizational survival was used as a dependent variable, partialling out the control variables noted earlier.

Hypothesis 2a (agency prediction) would be supported if the coefficient for the succession measure (either individually or cumulative) is positive and statistically significant, indicating that agent changes have a salutary effect on organizational survival. Hypothesis 2b (scapegoat prediction) would be supported if the regression coefficients for the succession measures fail to reach statistical significance. Lastly, Hypothesis 2c (population ecology prediction) would be supported if the coefficients for managerial succession are negative and statistically significant, indicating that executive changes would tend to precipitate organizational mortality.

We also tested the type of statistical distribution most appropriate to examine the relation between executive exit and firm failure (Levinthal, 1991). The model that best fit the data for the correlation between executive transitions and organizational survival is lognormal after comparing it with loglogistic, Weibull, and Gompertz distributions. Therefore, the lognormal transformation was chosen.

Hypothesis 3a will be tested by examining whether or not executive tenure decreases at a lower pace as the firm's probability of failure increases. This hypothesis would be supported

if the observed relationship between executive tenure and the firm's probability of failure is convex in nature. Similarly, following the logic of the third hypothesis, while the relationship between executive tenure and the firm's probability of failure should be asymtotic in nature for both the CEO and the editor (hypothesis 3a), at any given point of the probability of failure distribution the tenure of the CEO will be higher than that of the editor (indicating greater entrenchment power for the former, as per hypothesis 3b).

RESULTS

Table 1 presents descriptive population statistics and Table 2 shows the frequency of successions. As can be seen in Table 2, there were 609 CEO successions and 899 editor successions, with the majority of firms having four or less CEO changes (553 or 91%) and six or less director changes (826 or 92%). The maximum number of successions experienced by any newspaper during the observation period was eight CEO exits and eleven editor exits. Table 3 and 4 presents means, standard deviations, and bivariate correlations for all variables.

Table 5 shows the event analysis results with tenure of the CEO (column 1) and the editor (columns 2 and 3) as dependent variables. The observed performance coefficient is negative and statistically significant for all models, indicating that executives are more likely to be terminated when performance declines. However, as argued by hypothesis 1, the magnitude of the performance effect is much greater for the editor (column 2), even after controlling for family ties between the CEO and the editor (column 3). The differences between the performance coefficients between columns 1 and 2, and columns 1 and 3, are statistically significant at $p \leq .0001$ using the likelihood ratio statistic test, supporting hypothesis 1.

Table 6 presents the model results with organizational survival as the dependent variable and each succession event as an independent variable, partialling out the control variables. Only four successions are shown in Table 6 for the CEO (which includes 91% of the exits) and four for the director (which includes 86% of the exits) since this sufficiently covers most of the cases.Columns 1-4 in Table 6 presents the model results for the CEO, while columns 5-8 present the model results for the editor . As can be seen in column 1, the total number of CEO successions is highly related to organizational survival ($p \leq .0001$), although

the statistical significance of this coefficient drops considerably when all the control variables are included in the equation ($p \leq .10$, as shown in column 2). These findings are mirrored when we examine the impact of each unique CEO succession event as a dummy variable. As can be seen in column 3, the coefficients for the CEO dummy succession variables are all statistically significant at $p \leq .0001$, yet it appears that the marginal gain of executive transitions in terms of organizational survival decreases as the number of successions increases. Incorporating the control variables in the equations (column 4) reduces the magnitude of the individual CEO succession coefficients, yet most remain as statistically significant at $p \leq .05$.

The pattern is similar when we examine the editor equations (columns 6-8), although the magnitude of the coefficients tend to be greater for the CEO. As can be seen in column 1 (which does not include control variables) and column 2 (which includes control variables) the total number of editor succession events shows a highly significant association with organizational survival ($p \leq .0001$). Similarly, each unique editor succession event has an independent positive impact on survival (at least at $p \leq .001$ as seen in column 3), with most of the succession events remaining as statistically significant after the control variables are included in the equation.

The results in Table 6 strongly support the agency interpretation (hypothesis 2a) in that changes at the top of the newspapers are associated with improved organizational survival. In other words, when a firm replaces a top executive it has reasons to suspect that a change in stewardship can help enhance organizational survival and more often than not this suspicion turns out to be true. Therefore, the overall impact of the change is not merely cosmetic or symbolic (scapegoat effect) nor deleterious to the firm (as argued by population ecologists).

To determine if the tenure of the CEO is greater at any given point of the probability of failure continuum (hypothesis 3b), a separate analysis was conducted for the CEO and the editor with agent tenure along the vertical axis and the firm's probability of failure along the horizontal axis. The graphical depiction of the relationship between exit events and organizational survival for the CEO and the editor is shown in Exhibit 1. For both executives, the survival of the newspaper (measured in terms of age) increases as a function of number of

exits, but the nature of the relationship varies. The curve is much steeper for the CEO than for the editor, indicating that organizational survival (measured by age) increases much faster for the CEO than the editor as the total number of successions increases. This indicates that the net benefits of changing the CEO are greater than that of replacing the editor as firm performance declines, supporting the common sense notion that the actions and decisions of the CEO who is responsible to formulate and implement overall strategies are far more important to the firm than those of the next management level.

The relationship between performance and executive tenure is lognormal, indicating that as performance deteriorates, executive tenure decreases at a lower rate. The shape of this relationship is convex as shown graphically in Exhibit 2. In other words, the "frictions" for dismissing the executive appear to increase as performance worsens. We interpret these findings as evidence that managerial entrenchment increases as the probability of organizational failure increases, supporting Hypothesis 3a.

In support of hypothesis 3b, Exhibit 2 shows that while the relationship between executive tenure and performance is convex for both CEO and editor, the editor is less likely to successfully engage in entrenchment practices because the tenure of this person is always substantially below that of the CEO even when performance (measured by the probability of failure) is at its worst. In fact, when the probability of failure is 100% (right hand corner of Exhibit 2) the CEO remains on the job for 7 years while the editor remains on the job for 2 years. In light of the fact that the positive impact of managerial succession on organizational survival (measured by age) is much greater for the CEO than the editor (as per Exhibit 1 and our discussion above) these results suggest that managerial entrenchment may be partly responsible for shorter organizational survival.

DISCUSSION AND CONCLUSIONS

The results presented here indicate that monitoring mechanisms operate differently when there is a relational contract between the executive and the firm. This is evidenced by the fact that the CEO who has family ties to the principal is less subject to disciplining by the principal in the face of declining performance than the next executive (i.e., the editor). An

alternative, albeit complementary interpretation is that the presence of a relational contract facilitates top executive entrenchment to the detriment of the principal. In other words, the executive can take advantage of the principal under a relational contract by decoupling employment risk (i.e., being replaced) from observed performance outcomes. There are several reasons that support this interpretation. First, the CEO is less likely to be terminated than the editor as firm performance declines. This means that the editor somehow gets blamed for poor performance results and gets replaced accordingly. The CEO, on the other hand, can insulate himself/herself from downward performance pressures much better than the editor. In a sense, the editor becomes the scapegoat for poor results. Second, CEO replacements have a much greater positive effect on survival than editor changes. Therefore, while the editor has less influence over the factors that influence firm performance, he/she is still held more accountable for performance results than the CEO whose activities and decisions are more pivotal to organizational performance. This seeming contradiction can only be understood from a CEO entrenchment perspective. Third, the editor is likely to be terminated for poor performance results over which he has less control than the CEO <u>regardless</u> of <u>family ties to the CEO.</u> This means that a relational contract protects the CEO, who has more power than the editor, but does little to help the editor in the face of poor performance. Finally, the convex relationship between executive tenure and the probability of firm failure indicates that many executives are able to hold onto their jobs even as the eventual firm's demise becomes clearer and clearer. For instance, the CEO can hold onto his/her job more than three times longer than the editor as the expected probability of business failure approaches 100%.

Our interpretation of the above findings is consistent with prior research by Boeker (1992) who found that the powerful CEOs were able to deflect scapegoating and pass it on to their fellow executives. In a recent book, Finkelstein and Hambrick (1996: 202) expand on Boeker's preliminary empirical results ". . . [executive] departure reflects power. . . Boeker did not examine which specific executives were dismissed, but we could reasonably expect that their individual power would be highly predictive of their own retention versus departure." They go on the advance the following proposition, which we empirically support in this study: "the greater the executive's power within a top management group, the less

likely he or she is to be dismissed when the firm is performing poorly" (Finkelstein & Hambrick, 1996: 202).

The research reported here does not support the notion that changes at the top of the organization make little difference nor that executive succession tends to precipitate organizational failure. We find exactly the opposite, more in line with the agency argument that disciplining managers (though dismissal in the case of poor performance) enhances organizational survival. It is important to note that the sample used here fully adheres to an ecological context in which failure can occur relatively easy. Most newspapers are small, with limited resources and "slack", operating in a very competitive environment with few entry barriers, and sold in a relatively poor European country with one of the lowest percentages of the population that regularly reads a newspaper. Therefore, if top executive changes were to precipitate organizational mortality, our sample provides a rather favorable context to observe this effect, yet we find that the reverse is true.

Our findings are consistent with those of Singh et al. (1986) who found that among voluntary agencies organizational changes are associated with a lower death rate. Singh et al. (1986: 610), however, raised an important question which their study could not answer : "the adaptive or descriptive consequence of change found in this study may simply be statistical accidents (type I errors) rather than consequences of systematic organizational processes. Changes that are 'lucky' seem in retrospect, adaptive, and 'unlucky' changes seem disruptive. Such a random variation view may well be correct but we think that the question is an empirical one." It would be very difficult to reconcile our results with a random "lucky" or "unlucky" event explanation. Clearly, the weight of the evidence is more congruent with an agency interpretation in that when firms discipline executives (i.e., dismissal) they do so for good reasons (i.e., poor performance) and these changes tend to enhance organizational survival.

Our findings agrees with those of Haveman (1993: 869) in that the effect of succession on organizational survival is stronger for presidents (i.e., CEO) than for other managers (i.e., editor) "consonant with the expectation that the behavior of the most powerful individual has the greatest effect on organizational outcomes." Yet, contrary to Haveman, our models show

a positive rather than a negative impact of organizational succession on performance. Haveman also found that the negative effect of succession on organizational survival diminishes overtime so that the impact is stronger immediately following a succession event. In the present study, we found a positive impact either immediately following each succession event or for the total number of cummulative successions overtime.

Clearly, much research needs to be done on these issues given the conflicting results reported in the literature. Perhaps, the salutary or negative effects of executive succession on organizational mortality may be peculiar to each organizational population. Their effects may be more disruptive in other populations such as those used by Haveman (1993), Carroll (1984) and Amburgey, Kelly, and Barnett (1993). Yet our results seem to fit nicely with agency predictions in that monitoring (reflected in the performance - executive tenure relations) is beneficial to the principal and that if given an opportunity executives will entrench themselves, avoiding full accountability for their actions. This suggests that in the absence of good information principals may be better off attributing poor organizational performance to managers for the reasons noted by Walsh and Seward (1990) in their review of the literature: (a) the principal may reason that it is the manager's job to guide the firm to success in any environment, no matter how constraining; (b) it is very difficult to sort out the effect of an uncertain/challenging environment from managerial incompetence and (c) the principal has the ability to make changes in management, even though altering the environment is difficult.

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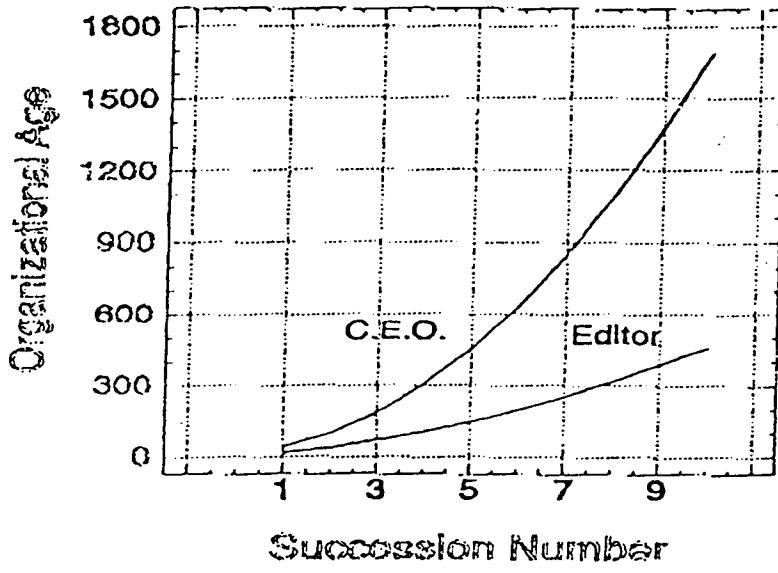
Exhibit 1
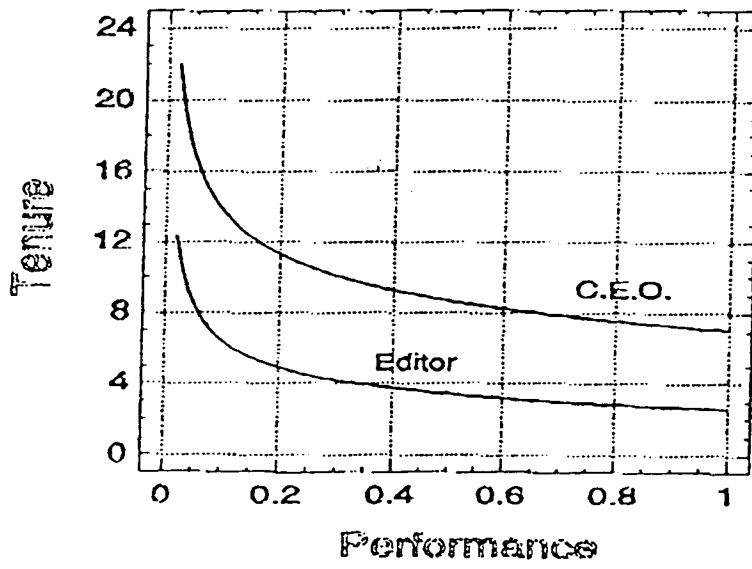
Exhibit 2

TABLE 1
POPULATION CHARACTERISTICS

Variables	Number
Total Number of Newspapers	276
Age at time of failure	276
CEO Tenure	609
Editor Tenure	899
Relational Tie CEO-Editor	40
Probability of Failure for CEO	314
Probability of Failure for Editor	426
Age at time of CEO Succession	609
Age at time of Editor Succession	899
Firms born before 1966	119
Party Affiliation	42
Density	276
Own Printing Press	110
Capital Structure	133

TABLE 2
Frequency Distribution of Managerial Succession Events

Variables	Number of Successions											Total
Frequency	0	1	2	3	4	5	6	7	8	9	10	
CEO	237	155	105	56	25	14	10	7	0	0	0	609
Editor	264	181	138	108	80	55	33	19	10	6	5	899

TABLE 3
Means, Standard Deviations, and Correlations for Tenure

Variable	CHIEF EXECUTIVE OFFICER								EDITOR						
	Means	s.d.	1	2	3	4	5	6	Means	s.d.	1	2	3	4	5
log(pr(failure))	-1.02	0.86							-1.04	0.89					
Age of Succession	38.51	34.95	-0.04						39.27	36.55	-0.00				
Firms before 1966	0.63	0.48	0.00	0.72					0.63	0.48	-0.04	0.70			
Party affiliation	0.24	0.43	0.01	0.09	0.43				0.26	0.44	-0.08	0.08	0.45		
Own Printing Press	0.79	0.40	-0.01	0.42	0.58	0.27			0.80	0.39	-0.05	0.41	0.61	0.28	
Capital structure	0.92	0.26	0.03	0.17	0.29	0.20	0.17		0.94	0.21	0.06	0.07	0.22	0.17	0.08
Relational Ties	0.05	0.22	-0.07	0.10	0.06	-0.08	0.02	-0.14							

TABLE 4
Means, Standard Deviations, and Correlations for Survival

Variables	CHIEF EXECUTIVE OFFICER												EDITOR										
	Means	s.d.	1	2	3	4	5	6	7	8	9	10	Means	s.d.	1	2	3	4	5	6	7	8	9	10
Total Succession	0.67	0.61											0.94	0.75										
1st Succession	0.21	0.41	0.02										0.16	0.37	-0.14									
2nd Succession	0.16	0.37	0.33	-0.23									0.11	0.32	0.07	-0.15								
3rd Succession	0.07	0.26	0.36	-0.14	-0.12								0.10	0.30	0.20	-0.14	-0.12							
4th Succession	0.03	0.18	0.32	-0.10	-0.10	-0.08	-0.05						0.08	0.28	0.27	-0.13	-0.11	-0.10						
More than 4th	0.04	0.20	0.49	-0.11	-0.09	-0.06	-0.04						0.19	0.39	0.68	-0.21	-0.17	-0.17	-0.16	-0.15				
Density	132.1	12.6	0.11	-0.01	0.04	0.05	0.03	0.09					132.1	12.6	0.09	-0.00	0.01	0.18	0.00	-0.00				
Before 1966	0.43	0.49	0.51	0.04	0.30	0.21	0.10	0.20	-0.04				0.43	0.49	0.52	-0.18	0.14	0.02	0.25	0.35	-0.01			
Party Affiliation	0.15	0.35	0.37	-0.04	0.05	0.18	0.13	0.30	-0.16	0.48			0.15	0.35	0.33	-0.13	0.09	-0.03	0.01	0.33	-0.16	0.48		
Own Printing Press	0.76	0.42	0.09	-0.04	0.14	0.07	0.00	0.03	0.19	0.63	0.31		0.76	0.42	0.13	-0.16	0.11	-0.03	0.14	-0.01	0.19	0.63	0.31	
Capital Structure	0.89	0.30	0.22	0.01	0.04	0.12	0.08	0.09	-0.00	0.27	0.20	0.23	0.89	0.30	0.09	0.05	0.02	-0.15	-0.11	0.19	-0.00	0.27	0.20	0.23

TABLE 5
EFFECT OF PERFORMANCE AND RELATIONAL TIES ON TENURE

	CEO	EDITOR	CEO-EDITOR FAMILY TIES
Constant	1.56*	0.36	0.57
Performance	-0.28**	-0.38****	-0.35****
Relational Ties x Performance			
Age at Succession	0.01*	0.01**	0.01*
Firms born before 1966	0.15	-0.38	-0.41
Party Affiliation	-0.96****	-0.59**	-0.65***
Own Printing Press	0.40	0.18	0.28
Capital Structure	-.038	0.51	0.43
x^2	21.51**	18.22**	15.90*
df	6	6	8

p<0.0001****; p<0.001***; p<0.01**; p<0.05*; p<0.1

x^2 (20) = 42.93**** for univariable model
(20) = 37.50**** for global model

TABLE 6
Effect of Succession on Organizational Failure

	CHIEF EXECUTIVE OFFICER				EDITOR			
	Total Successions Without Control Variables	Total Successions With Control Variables	Individual Successions Without Control Variables	Individual Successions With Control Variables	Total Successions Without Control Variables	Total Successions With Control Variables	Individual Successions Without Control Variables	Individual Successions With Control Variables
Constant	2.23****	-4.87****	1.84****	-7.15****	1.65****	-7.31****	1.42****	-6.92****
Total Successions	2.17****	0.27*			1.87****	0.56****		
1st Succession			2.02****	0.62*			1.21***	0.49
2nd Succession			2.99****	0.53*			3.24****	1.02**
3rd Succession			3.63****	0.98*			2.93****	1.28**
4th Succession			3.61****	1.17*			3.26****	0.55
More than Fourth Succession			3.77****	0.40			3.54****	1.23****
Density		0.05****		0.07****		0.06****		0.06****
Firms born before 1966		1.92****		2.22****		2.14****		2.12****
Party affiliation		-0.61**		-0.73**		-0.68**		-0.80***
Own printing Press		0.61*		0.77**		0.75**		0.83**
Capital Structure		0.05		0.37		0.64		0.62
x^2	33.59****	69.43****	48.55****	71.58****	45.85****	78.10****	56.02****	78.35****
df	1	6	5	10	1	6	5	10

$p < 0.0001$****; $p < 0.001$***; $p < 0.01$**; $p < 0.1$*