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경영학석사학위논문

# **The impact of forced turnover on new CEOs' earnings overstatement**

전임자의 비자발적 사임이 새로 임명된 경영자의  
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# The impact of forced turnover on new CEOs' earnings overstatement

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## Abstract

This study explores whether forced turnovers influence the newly appointed CEOs' opportunistic behavior. Prior literature finds that CEOs overstate earnings greater in the early years than later years of tenure. However, this study finds that this earnings overstatement trend is disappeared when predecessor is likely to be forced to leave. In this case, the newly appointed CEOs hesitate overstate earnings in the early years, and this mitigate the difference in earnings manipulation between two periods.

**Keywords:** Earnings management, CEO turnover, Career-concern, CEO departure, Forced turnover, Overstatement

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## 1. INTRODUCTION

Previous studies of the myopic decisions for CEOs' self-interest behavior have arisen several academic interests. The number of researchers investigates earnings management conducted by CEOs during their work periods, and proves that CEOs manage short-term earnings performance that results in higher reported earnings subsequent years at expense of long-term firm value (e.g., Strong and Meyer, 1987; Graham et al, 2005; Roychowdhury, 2006; Antia et al, 2010). Also, prior literature finds the CEOs' discretionary behavior based on their timing.<sup>1</sup> Especially, Ali and Zhang (2015) find an earnings overstatement trend that CEOs manipulate earnings greater in the early years of their service rather than later years. However, the focus on this trend of new CEOs who succeed forcibly resigned CEOs has remained relatively unexplored due to unavailability to reach the data. This study explores whether newly appointed CEOs overstate earnings in the early years of service even when they succeed predecessors who are forced to leave the firms. The study predicts that their earnings

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<sup>1</sup> For instance, Ali and Zhang(2015) focus on CEOs' early years of service while Kalyta(2009) highlights CEOs' later years of service.

overstatement trend would be mitigated. In addition, I investigate how these CEOs' opportunistic behaviors are differentiated by the timing and the type of departure. The study expects that the difference of new CEOs' myopic decision is smaller between early and later years compared to routine CEOs' successions.

Even though corporate provisions such as 2002 Sarbanes-Oxley enhance the internal controls, those systems do not effectively control managers to overstate earnings (Hazarika et al. 2012). Various career-concerns literature illuminates a nature of managerial motivation to sacrifice firm's long-term value in order to achieve short-term earnings target that could belie the market recognition on CEOs' ability whether they have proficient competitiveness (e.g., Fama, 1980; Holmstrom, 1999). Thus, CEO's career-concern could result in myopic decision to build a reputation for retaining current position or catching future job opportunities. Also, compensation would motivate CEOs to engage in managerial discretion (Gibbons and Murphy, 1992). In this light, CEOs may have incentives to manipulate earnings performance in the early years of tenure. According to Ali and Zhang (2015), the authors demonstrate that CEOs are more likely to overstate earnings in the early years compared to later years of their tenure. However, in the case of new CEOs who follow the forcibly resigned

managers, it is possible that new CEO may hesitate to manipulate earnings. For example, forced turnover may enhance internal controls that inhibit managers to engage in earnings manipulation. Thus, it would be meaningful to investigate the current CEOs' earnings management based on predecessors' type of departure. The study predicts that forced departure would show other than positive and significant for discretionary accruals and negative and significant for abnormal discretionary expenses.

The prior evidences are likely to suggest that the market judges fired CEO as a poor performer. In such case, the CEOs may have greater incentives to engage in manipulation to mask their performance, so that they could get better job opportunities or receive better compensation after their resignation. However, the crucial point is that outsiders such as investors and researchers do not know whether CEO is voluntarily or involuntarily resigned his or her firm. Gow et al. (2017) introduce a model, designed by Daniel Schaubert, that helps to judge the type of CEOs' departure. Push Out Score has 9 dimensions to evaluate the type of CEO departure that range from 0 to 10; scores from 6 to 10 suggest robust sign that CEO is removed his or her position forcibly. I hand-collect the type of departure by following this model, and apply to empirical research.

The empirical result suggests that earnings overstatement trend is mitigated when CEOs are forced to leave. This study identifies that CEOs who succeed involuntary resigned predecessors do not show the earnings overstatement trend that early years are greater than later years. For the sample period 1998-2014, CEOs who are likely to succeed involuntary CEOs succession show same indication in both abnormal discretionary accruals and expenses. In addition, I could find that this mitigation of earnings overstatement is caused by CEOs' opportunistic behavior in the early years of service, meaning that overstatement in the later years does not show any difference to voluntary turnover.

This study makes the following contributions. First, the study shed light on a clue that new CEOs' opportunistic behavior in the early years of tenure in the particular circumstance. Second, the paper attempts to solve the puzzle how and when the earnings overstatement trend would be weakened by newly appointed CEOs' implementation. On the other hand, this study has the following limitation. Even though hand-collected data could be a yardstick to evaluate that CEO is involuntarily resigning the firm, this method does not explicitly indicate that CEO is actually fired. So, a further sophisticated study is necessary to investigate this issue. Also, the study



investigates the new CEOs' opportunistic behavior with relatively small sample, so that endogeneity issue may arise.

The remainder of the paper is organized as follows. The next section develops the hypothesis. Section 3 discusses the research design. Section 4 presents the sample and descriptive statistics. Section 5 shows the empirical results. Section 6 discusses limitation and further study and section 7 concludes the paper.

## **2. HYPOTHESIS DEVELOPMENT**

To develop the hypothesis, understanding nature of incentive to manipulate earnings is necessary to explain new CEOs' earnings overstatement. Firstly, CEOs who worry about their career concern tend to sacrifice long-term firm value in order to boost current earnings performance that enhance their reputation. For example, Dikolli et al. (2013) explain the career-concern within a framework of the short-horizon agency problem (Holmstrom, 1982). Secondly, CEOs who do not have the career concern

would overstate earnings to increase compensation (e.g., Healy and Wahlen; 1999, Dechow and Skinner; 2000, Fields et al; 2001).

Almost 80% of financial executives respond that meeting earnings target would improve their reputation in the market (Graham et al, 2005). This survey-based study may provide insight that career-concerns could be one of major interest to CEOs because earnings performance failure may be interpreted as a low ability manager by the market. For instance, Graham et al find that 80% of managers prefer a method to meet the earnings target by decreasing discretionary expenditures such as research and development and advertising expenses. Also, Gibbons and Murphy(1992) show the market characteristic that the market casts doubt on newly appointed CEO's ability. In this sense, CEOs may have a strong incentive to build their reputation, so that they could retain their position. Thus, newly appointed CEOs' motivation to manipulate earnings in the early years would be related to career concern.

Managers' compensation structure may also relate to earnings management. For instance Baker et al. (2003) argue that compensation structure with high option lead CEOs to engage in earnings manipulation. Also, earnings overstatement is pronounced when managers' compensation is related to stock and option (Bergstresser and Philippon, 2006). Therefore,

new CEOs who make a contract with high stock option may lead them to manipulate earnings in order to increase their compensation near the future.

Above two explanations explaining opportunistic behavior are likely to be suitable for normal succession CEOs. On the other hand, it is unlikely to be applied for newly appointed CEOs who succeed forcibly resigned predecessors. Managers are likely to leave regardless of their willingness to stay firms when the companies wish to restructure business strategy. Coles et al. (2006) find evidence that policy change generally result in a compensation structure change. This evidence may illuminate an insight that incumbent CEOs could take a riskier action when they feel that their statuses are in danger. For these CEOs, they could aggressively engage in earnings manipulation in order to retain their position. Thus, it is likely that CEOs who are forced to resign may manipulate earnings largely during later years of service. After all, newly appointed CEOs may hesitate to engage in opportunistic behavior because of predecessors' earnings overstatement.

Also, poor performance is likely to be related with turnover (McEvoy et al, 1987). Especially, Allgood and Farrell (2000) find the negative relation between forced turnover and performance. In this case, forced turnover would lead corporate governance and monitoring to be tightened. In this regard, newly appointed CEOs' self-serving behavior would be weakened

because CEOs are generally showing risk-averse characteristic. Thus, the new CEOs who succeed position that is vacated by forcibly resigned predecessors may reluctant to manage earnings. Taken together, new CEOs would hesitate to exert managerial discretion in the early years of service who succeed forced turnover position.

**H1:** Earnings overstatement trend that overstate earnings greater in the early years than later years would be mitigated in the case of forced turnover succession.

Next, this paper investigates the difference in earnings overstatement between early and later years when newly appointed CEOs succeed forced turnover position. According to Murphy and Zimmerman (1993), newly appointed CEOs have incentives to write down assets and take earnings baths. This finding may give an insight that new CEOs would hesitate to manipulate earnings in the early years. When new CEOs think that earnings overstatement is not beneficial, their self-serving characteristic would lead them to less manipulate earnings.

CEOs who are likely to be forced to leave show that they engage in earnings overstatement in later year of their service (Hazarika, 2012). On the

other hand, new CEOs also have an incentive to overstate the earnings because they concern the market perception whether they are evaluated as low ability CEOs. CEOs recognized as high ability are likely to receive not only higher compensation in the future but also contract extension. Thus, this motivation triggers CEOs to exert overstatement for make-up their capacity. However, new CEOs could hesitate to overstate earnings when predecessors forcibly leave the firm because predecessors may already engage in earnings management largely. These circumstances may lead earnings overstatement trend to be mitigated.

However, it is necessary to explain how earnings overstatement trend would be mitigated when there is involuntary turnover succession. Let's assume that a new CEO who succeed voluntary resigned predecessor overstates earnings by 4 in the early years and 2 in the later years. In this case, difference in earnings manipulation is 2. If involuntary turnover is occurred, then difference of earnings would be less than 2. There are at least three conditions for this issue: CEOs manages earnings by 3 in the early years(later years) when later years(early years) manipulation is fixed by 2(4), then the difference in earnings overstatement is 1 in both situations. Also, earnings manipulation could be changed in the both periods that result in zero difference.

**H2:** The difference in earnings overstatement between the early years and the later years of service is smaller when the newly appointed CEO succeed predecessor who forcibly leave the firms.

### **3.EMPIRICAL RESEARCH DESIGN**

#### *3.1 Type of CEO turnover*

Even though the market has strong interests on the type of CEO departure, the public cannot know whether CEO is voluntary leave a company or not. This is because a company does not explicitly mention on a press release or disclosures such as 8-k and 10-k. For example, a small number of sample (3.6%) among the total sample indicate explicitly why CEO is removed from the company. Among the news, major reasons for CEOs' departures are related to other job opportunities, medical issue, and investigation. This unavailability may be attributed to the firm value that could be directly influenced by bad news (Skinner, 1994). Thus, various studies design to evaluate CEOs' departure type. For instance, Huson et al. (2001) classified forced turnover if CEOs leave the firm due to policy change,

or CEOs' age is less than 60, or CEOs resigns position with six month of the announcement. In this paper, I attempt to follow a model being called Push Out Score that is designed by Daniel Schaubert.

Gow et al. (2017) introduce the Push Out Score to classify the type of CEOs' departure whether CEOs are voluntarily or involuntarily stepped down. The model has 9 dimensions, and each dimension is assigned a 1 if the information shows alarming signs. The score is assigned to 1 if: 1) Form of the management change announcement is not released in disclosure such as 8-k, and 2) the press release mentions management change without predecessors' accomplishments and warm words, and 3) the CEO's departure has occurred under 60<sup>2</sup>, and 4) the CEO's departure is announced after his or her resignation, and 5) the CEO's tenure is shorter than same industry CEOs' tenure, and 6) the current share price is decreased compared to previous year, and 7) the official reason to leave such as having other job opportunity is not given, and 8) 10-k comments that there is a conflict between firm and manager such as litigation, and 9) newly appointed CEO is outsider or interim-base.

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<sup>2</sup> According to Murphy(1999), the majority of CEOs' departure takes place between the ages of 60-66 (66%).

The sum of the dimensions indicates the type of CEOs' departure whether the CEOs voluntarily leave the firm or not. Scores from 6 to 9 (2 to 5) suggest robust (significant) sign that CEO is removed his or her position forcibly. However, if the score indicates less than 2, then it is unlikely to be related to involuntary CEO turnover.<sup>3</sup> In this paper, however, I classify involuntary CEO turnover if score is above 5 and voluntary CEO turnover if score is less than 6.

### *3.2 Earnings Management*

After defining the type of CEO turnover, I follow the Ali and Zhang(2015) to calculate the abnormal discretionary accruals and expenses. First, this paper adopts a accruals model which is developed by McNichols(2012) to estimate the abnormal accruals. This model is a preliminary stage to capture the empirical results for accruals earnings manipulation.

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<sup>3</sup> If the definite information is given that CEO is fired (not fired), the score is assigned a 10 (0).



$$\begin{aligned}
ACC_{it} / A_{it-1} = & \beta_0 + \beta_1(CFO_{it-1} / A_{it-2}) + \beta_2(CFO_{it} / A_{it-1}) \\
& + \beta_3(CFO_{it+1} / A_{it}) + \beta_4(\Delta REV_{it} / A_{it-1}) + \beta_5(PPE_{it} / A_{it-1}) \\
& + \varepsilon_{it}
\end{aligned}
\tag{1}$$

All data are obtained on the Compustat database with limiting industry-year group required to have at least ten observations.<sup>4</sup> The residuals of the equation (1) indicate the abnormal accruals. The definitions of variables are as follows.  $ACC_{it}$  is the accruals of firm  $i$  in year  $t$ , measured as difference between earnings before extraordinary items and cash flow from operations.  $A_{it(t-1, t-2)}$  is total asset of firm  $i$  at the end of year  $t(t-1, t-2)$ .  $CFO_{it(t-1, t+1)}$  is cash flow from operations of firm  $i$  at the end of year  $t(t-1, t+1)$ .  $\Delta REV_{it}$  is changes in revenue in year  $t$  and  $PPE_{it}$  is gross property, plant, and equipment in the beginning year of  $t$ .

Second, I adopt a model which is developed by Roychowdhury(2006) to estimate the abnormal level of discretionary expense. This model is a preliminary stage to capture the real-based earnings management.

$$DISEXP_{it} / A_{it-1} = \beta_0 + \beta_1(1 / A_{it-1}) + \beta_2(S_{it-1} / A_{it-1}) + \varepsilon_{it}
\tag{2}$$

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<sup>4</sup> The discretionary accruals are estimated by two-digit industry-year group.

This model is grouped by two-digit industry-year and data are obtained on the Compustat database that have at least ten observations. The residuals of the model indicate the abnormal discretionary expenses. The definitions of variables are as follows.  $DISEXP_{it}$  is sum of R&D, advertising, and selling, general and administrative expenses, indicating discretionary expenses of firm  $i$  in year  $t$ . If R&D and advertising expenses are missing, but SG&A expenses are accessible, former two variables are assigned to zero.  $A_{it-1}$  is total asset of firm  $i$  at the end of year  $t-1$ .  $S_{it-1}$  is sales of firm  $i$  at the end of year  $t-1$ .

### 3.3 Estimation Methodology

The following Eq.(3) and (4) is the main regression model to test the hypothesis. Those two models are following Ali and Zhang (2015). Equation (3) and (4) is observing abnormal discretionary accruals and abnormal discretionary expenses respectively.

$$\begin{aligned}
 \text{Abnormal accruals}_{it} &= \delta_0 + \delta_1 \text{Early Years}_{it} + \delta_2 \text{MVE}_{it-1} + \delta_3 \text{MTB}_{it-1} \\
 &+ \delta_4 \text{Litigation}_{it} + \delta_5 \text{Leverage}_{it-1} + \delta_6 \text{ROA}_{it} + \delta_7 \text{Loss}_{it} \\
 &+ \delta_8 \text{PPE}_{it-1} + \delta_9 \text{CFO}_{it} + \tau_{it}
 \end{aligned}
 \tag{3}$$

To investigate the CEOs' opportunistic behavior, I separate the CEO's departure type based on the score that I mentioned in the 3.1. Then, I analyze the model respectively. The definitions of variables are as follows. *Early years<sub>it</sub>* is an indicator variable that equals one for CEOs' first three years of entire tenure. *MVE<sub>it</sub>* is the logarithm of market value of equity at the beginning of year *t*. *MTB<sub>it</sub>* is the market value of equity divided by the book value of equity at the beginning of year *t*. *Litigation<sub>it</sub>* is one if the firm is in high litigation industry (SIC 2833 to 2836, 3570 to 3577, 3600 to 3674, 5200 to 5961, and 7370 to 7374). *Leverage<sub>it</sub>* is total debt divided by total assets at the beginning of year *t*. *ROA<sub>it</sub>* is earnings before extraordinary items in year *t* scaled by total assets at year *t-1*. *PPE<sub>it-1</sub>* is property plant and equipment scaled by asset in the year *t-1*. *Loss<sub>it</sub>* indicates one if net income is below zero in year *t*. *CFO<sub>it</sub>* is cash flow from operation in the year *t* scaled by asset in the year *t-1*. *Early years<sub>it</sub>* is the main variable to test the hypothesis. In the case of new CEOs who succeed voluntary retired CEOs, the main variable would be positive and significant, indicating that these new CEOs overstate earnings greater in the early years than later years of incumbent period. If *Early years<sub>it</sub>* is positive and significant, the result is consistent with Ali and Zhang(2015). However, in the case of predecessors who involuntarily leave the firms, I predict that result should show other than positive and significant

for the *Early years<sub>it</sub>*, indicating that newly appointed CEOs are hesitate to manipulate earnings in the early years of service.

$$\begin{aligned}
 & \text{Abnormal Discretionary Expenses}_{it} \\
 & = \delta_0 + \delta_1 \text{Early Years}_{it} + \delta_2 \text{MVE}_{it-1} + \delta_3 \text{MTB}_{it-1} \\
 & + \delta_4 \text{Leverage}_{it-1} + \delta_5 \text{Sale}_{it-1} + \delta_6 \text{ROA}_{it} + \tau_{it}
 \end{aligned}
 \tag{4}$$

Similar to equation (3), I analyze the eq.(4) model based on CEOs' type of departure. The definitions of variables are as follows. *Early years<sub>it</sub>* is an indicator variable that equals one for CEOs' first three years of entire tenure. *MVE<sub>it</sub>* is the logarithm of market value of equity at the beginning of year *t*. *MTB<sub>it</sub>* is the market value of equity divided by the book value of equity at the beginning of year *t*. *Leverage<sub>it</sub>* is total debt divided by total assets at the beginning of year *t*. *Sale<sub>it-1</sub>* is sale scaled by asset in year *t-1*. *ROA<sub>it</sub>* is earnings before extraordinary items in year *t* scaled by total assets at year *t-1*. *Early years<sub>it</sub>* is the main variable to test the hypothesis. Similar to Ali and Zhang(2015), I predict that *Early years<sub>it</sub>* would be negative and significant for new CEOs who succeed voluntarily resigned CEOs, indicating that earnings overstatement is greater in the early years than later. However, for the new CEOs who take the position that was involuntarily vacated, I expect that main variable should be other than negative and significant.

To test second hypothesis, I observe newly appointed CEOs that they engage in opportunistic behavior during their early year of their service time. Especially, I expect that new CEOs who succeed the pressured CEOs would be reluctant to overstate the firms' earnings compared to routine CEOs. I design Eq.(5) and (6) to capture this phenomenon. In the Eq. (5) and (6), I expect that interaction term *Early years<sub>it</sub>\**. *Score<sub>it</sub>* for discretionary accruals would be negative while abnormal discretionary expenses model should represent positive. These results will show that newly appointed CEOs succeeding pressured predecessors are likely to less prevalent to overstate earnings even though they engage in earnings manipulation.

$$\begin{aligned}
& \text{Abnormal accruals}_{it} \\
& = \delta_0 + \delta_1 \text{Early Years}_{it} + \delta_2 \text{Score}_{it} \\
& + \delta_3 \text{Early Years}_{it} * \text{Score}_{it} + \delta_4 \text{Later years}_{it} \\
& + \delta_5 \text{Later Years}_{it} * \text{Score}_{it} + \delta_6 \text{MVE}_{it-1} + \delta_7 \text{MTB}_{it-1} \\
& + \delta_8 \text{Leverage}_{it-1} + \delta_9 \text{Litigation}_{it} + \delta_{10} \text{ROA}_{it} \\
& + \delta_{11} \text{Loss}_{it} + \delta_{12} \text{PPE}_{it-1} + \delta_{13} \text{CFO}_{it} + \tau_{it}
\end{aligned} \tag{5}$$

$$\begin{aligned}
& \text{Abnormal Discretionary Expenses}_{it} \\
& = \delta_0 + \delta_1 \text{Early Years}_{it} + \delta_2 \text{Score}_{it} \\
& + \delta_3 \text{Early Years}_{it} * \text{Score}_{it} + \delta_4 \text{Later years}_{it} \\
& + \delta_5 \text{Later Years}_{it} * \text{Score}_{it} + \delta_6 \text{MVE}_{it-1} + \delta_7 \text{MTB}_{it-1} \\
& + \delta_8 \text{Leverage}_{it-1} + \delta_9 \text{Sale}_{it-1} + \delta_{10} \text{ROA}_{it} + \tau_{it}
\end{aligned} \tag{6}$$

Most of variables are similar to previous model equation (3) and (4), however, I add the *later years<sub>it</sub>* to capture how the new CEOs earnings

overstatement is mitigated. For instance, if intersection term,  $Later\ years_{it} * Score_{it}$ , shows insignificant, the earnings overstatement trend is mitigated because of early years' earnings manipulation. Following Ali and Zhang(2015), I define early years as first three years of CEOs' tenure. Even though those authors indicate that this term would be arbitrary, however, I would adopt this by limiting CEOs tenure more than five years.

#### **4. SAMPLE AND DESCRIPTIVE STATISTICS**

For the years of 1994-2010, data on Push Out Score are obtained from the EDGAR database, 8-k and 10-k. CEO information is obtained from the Execucomp and financial statement data are obtained from the Compustat. 599 CEOs' departures are investigated and the mean (median) of CEO tenure is 9 (7) years in the sample.

Among the sample, 389 CEOs' Push Out Scores are less than 6 while remaining 210 CEOs' Push Out Scores are more than 6. However, actual used data for CEOs' turnover are 218 and 236 for real activities based manipulation and accruals manipulation. After all, those numbers are used

for observing newly appointed CEOs' opportunistic behavior from 1998 to 2014. Table 1 shows the descriptive statistics of the variables in the abnormal discretionary expenses. Table 2 shows classification of CEOs' turnover.

(TABLE 1 and 2. Here)

## **5. EMPIRICAL RESULTS**

### *5.1. Earnings overstatement analysis based on type of CEOs' departure*

Panel A and B of Table 3 shows the empirical results of the equation (3) and (4) respectively. The main variable of both equations is *Early Years* $sr_{it}$  and I analyze these models by predecessors' departure type.

Panel A of Table 3 observes CEOs' accruals based earnings management. In the panel A, the group of CEOs who succeed voluntarily resigned predecessors shows positive and significant, 0.0387(t-statistic=2.0). This result indicates that CEOs overstate earnings greater in the early years

of service that is consistent with Ali and Zhang (2015). However, the coefficient of abnormal CEOs succession shows negative but insignificant, -0.0146(t-statistic=-0.49). This result may support first hypothesis that earnings overstatement trend is mitigated in the case of forced turnover.

Panel B of Table 3 observes CEOs' real activities based earnings management. In the panel B, the group of CEOs who succeed voluntarily resigned predecessors shows negative and significant, -0.0935(t-statistic=-1.68). This empirical result shows that CEOs overstate earnings greater in the early years of service that is consistent with Ali and Zhang (2015). However, the coefficient of abnormal CEOs succession shows negative but insignificant, -0.0433(t-statistic=-0.67). This result also support first hypothesis that earnings overstatement trend is mitigated when CEOs are forced to leave.

(TABLE 3. Here)

## *5.2. The difference in Earnings overstatement of newly appointed CEOs*



Panel A and B of Table 4 shows the empirical results for Hypothesis 2. The main variables of both equations (5) and (6) are *Early Years<sub>it</sub>* and *Early Years<sub>it</sub>\* Score<sub>it</sub>*. Panel A shows new CEOs' discretion on abnormal accruals while panel B captures new CEOs' overstatement on abnormal discretionary expenses. *Early Years<sub>it</sub>* is weakly significant and positive in Panel A while the result is weakly significant and negative in Panel B. These results are consistent with prior study that CEOs overstate earnings in early year of their service time.

However, my main variables to test hypothesis 2 seem interesting. As I predicted in the H2, Panel A of table 4 shows that *Early years<sub>it</sub>\*Score<sub>it</sub>* is negative and significant, indicating that newly appointed CEOs who succeed pressured CEOs are likely to less prevalent to overstate earnings by using accruals based manipulations. However, unlike to H2, there is no significant sign on Panel B that newly appointed CEOs who succeed pressured CEOs are likely to less prevalent to overstate earnings using abnormal discretionary expenses. It supposes to be significantly positive, so this insignificance makes unable to support second Hypothesis. In the both Panel A and B, interaction terms, *Later Years<sub>it</sub>\*. Score<sub>it</sub>*, do not show any significant sign, indicating that mitigation of the earnings manipulation is caused by managers' opportunistic behavior in the early years.

(TABLE 4. Here)

## **6. LIMITATION AND FURTHER STUDY**

This study has following limitations. Firstly, this paper does not fully investigate the nature of CEOs' opportunistic behavior based on type of departure. This is because the paper deals with relatively small sample, so that it is unlikely to say that the empirical results would be generalized. Thus, endogeneity problems could be arise, so that it is required to collect more sample in order to correct this issue. For example, some of empirical results shows weakly significant or insignificant that leads limited explanatory power.

Secondly, this paper's methodology to classify the type of CEOs' turnover does not explicitly reveal that CEOs involuntarily resign the firms. I adopt Push Out Score and hand-collect the type of CEOs' turnover by using EDGAR database, Execucomp and Compustat. However, this score could be an yardstick to estimate the type of departure, but does not show the fact.

Therefore, this adoption may lead misleading results. Thirdly, the model is copyrighted, so that privacy issues may arise.

However, I believe that this study could be extended by connecting this issue to target setting. For example, Roychowdhury(2002), managers are generally manipulating earnings to meet the zero target. It will be interesting how target setting may be changed because of the forced turnover and how the new managers would behave upon this circumstance. Also, comparing earnings management reversal between voluntary turnover and involuntary turnover would be intriguing during the management change.

## **7. CONCLUSION**

This study explores whether the newly appointed CEOs' opportunistic behaviors are different between early years and later years of their service in the case of succeeding forced turnover. This paper expects that difference of new CEOs' myopic decision is smaller between early and later years in the case of involuntary turnover succession.

In the case of new CEOs who succeed the forcibly resigned managers, it is possible that new CEO may hesitate to manipulate earnings. For instance, increased corporate governance and attention from interest parties may inhibit managers to overstate earnings. Thus, it would be meaningful to investigate the current CEOs' earnings management based on predecessors' type of departure. The study predicts that involuntary turnover would show other than positive and significant for discretionary accruals and negative and significant for abnormal discretionary expenses. This inconsistency would lead earnings overstatement trend weakened. I classify the turnover type and investigate the how new CEOs' self-interest characteristic is influenced by forced turnover. The empirical results suggest that newly appointed CEOs' earnings overstatement trend is weakened when predecessors are forced to resign.

This study identifies that CEOs who succeed involuntary resigned predecessors do not show the earnings overstatement trend that early years are greater than later years. For the sample period 1998-2014, CEOs who are likely to succeed involuntary CEOs succession show same indication in both abnormal discretionary accruals and expenses. Also, I could find that this mitigation of earnings overstatement is caused by CEOs' opportunistic

behavior in the early years of service, meaning that earnings overstatement in the later years does not show any difference in voluntary turnover.

This study makes the following contributions. First, the study shed light on a clue that new CEOs' opportunistic behavior in the early years of tenure in the particular circumstance. Second, the paper attempts to solve the puzzle how the earnings overstatement trend would be weakened by newly appointed CEOs' implementation.

**Table 1**  
**Panel A: Discretionary Accruals**

	N	Mean	STD	Median	Q1	Q3
<i>Abnormal accruals<sub>it</sub></i>	602	-0.0127	0.1873	0.0053	-0.0572	0.0579
<i>Early Years<sub>it</sub></i>	602	0.2392	0.4270	0.0000	0.0000	0.0000
<i>MVE<sub>it-1</sub></i>	602	7.3265	1.6668	7.1998	6.3805	8.2546
<i>MTB<sub>it-1</sub></i>	602	0.2372	51.6865	1.8895	1.2071	2.8968
<i>Litigation<sub>it</sub></i>	602	0.3156	0.4651	0.0000	0.0000	1.0000
<i>Leverage<sub>it-1</sub></i>	602	0.2282	0.2521	0.1962	0.0701	0.3100
<i>ROA<sub>it</sub></i>	602	0.0419	0.1514	0.0457	0.0137	0.0860
<i>Loss<sub>it</sub></i>	602	0.1628	0.3695	0.0000	0.0000	0.0000
<i>PPE<sub>it-1</sub></i>	602	0.5950	0.4055	0.5332	0.2597	0.8806
<i>CFO<sub>it</sub></i>	602	0.1075	0.1022	0.1038	0.0631	0.1556

**Panel B: Abnormal Discretionary Expenses**

	N	Mean	STD	Median	Q1	Q3
<i>Abnormal expenses<sub>it</sub></i>	489	-0.1444	0.4807	-0.0896	-0.3272	0.0409
<i>Early Years<sub>it</sub></i>	489	0.1677	0.3740	0.0000	0.0000	0.0000
<i>MVE<sub>it-1</sub></i>	489	7.4734	1.5893	7.3231	6.4086	8.4297
<i>MTB<sub>it-1</sub></i>	489	1.2610	35.9005	1.8193	1.1467	2.7808
<i>Leverage<sub>it-1</sub></i>	489	0.2452	0.2568	0.2117	0.0921	0.3201
<i>Sale<sub>it-1</sub></i>	489	1.1949	0.8371	0.9890	0.6472	1.5028
<i>ROA<sub>it</sub></i>	489	0.0492	0.1070	0.0541	0.0201	0.0950

**Table 2**  
 Classification of CEO turnovers

	Voluntary Turnover	Involuntary turnover	Total
All	389(65%)	210(35%)	599(100%)
Real based Earnings Management	147(67%)	71(33%)	218(100%)
Accrual based Earnings Management	163(69%)	73(31%)	236(100%)

**Table 3 Panel A**Dependent variable: Discretionary Accruals<sub>it</sub>

	Forced turnover Succession		Voluntary turnover Succession	
	Coefficient	t-statistic	Coefficient	t-statistic
Intercept	0.1100*	1.7400	0.1458***	3.27
<i>Early Years</i> <sub>it</sub>	-0.0147	-0.4900	0.0387**	2.00
<i>MVE</i> <sub>it-1</sub>	-0.0128*	-1.7100	-0.0138***	-2.53
<i>MTB</i> <sub>it-1</sub>	0.0007***	3.7400	-0.0003	-1.53
<i>Litigation</i> <sub>it</sub>	0.0085	0.3000	0.0280	1.20
<i>Leverage</i> <sub>it-1</sub>	-0.1730***	-2.9800	-0.1078***	-2.98
<i>ROA</i> <sub>it</sub>	-0.0772	-1.1100	0.0614	0.54
<i>Loss</i> <sub>it</sub>	-0.0549	-1.3900	-0.1096***	-4.58
<i>PPE</i> <sub>it-1</sub>	0.1364***	4.5300	0.1224***	5.56
<i>CFO</i> <sub>it</sub>	-0.5006***	-3.6900	-1.0166***	-8.66
Adj. R <sup>2</sup>	0.25		0.24	
Observations	193		409	

\*\*\*, \*\*, \* indicate significance level at the 0.01, 0.05, and 0.1 respectively. *Abnormal Discretionary accruals*<sub>it</sub> is estimated as the residual of the discretionary accruals model of firm *i* at year *t*. *Early years*<sub>it</sub> is an indicator variable that equals one for first three years of management change. *MVE*<sub>it-1</sub> is the logarithm of market value of equity at the beginning of year *t*. *MTB*<sub>it-1</sub> is the market value of equity divided by the book value of equity at the beginning of year *t*. *Litigation*<sub>it</sub> is one if the firm is in high litigation industry (SIC 2833 to 2836, 3570 to 3577, 3600 to 3674, 5200 to 5961, and 7370 to 7374). *Leverage*<sub>it-1</sub> is total debt divided by total assets at the beginning of year *t*. *ROA*<sub>it</sub> is earnings before extraordinary items in year *t* scaled by total assets at year *t-1*. *PPE*<sub>it-1</sub> is property plant and equipment scaled by asset in the year *t-1*. *Loss*<sub>it</sub> indicates one if net income is below zero in year *t*. *CFO*<sub>it</sub> is cash flow from operation in the year *t* scaled by asset in the year *t-1*



**Table 3 Panel B**Dependent variable: Abnormal Discretionary Expenses<sub>it</sub>

	Forced turnover Succession		Voluntary turnover Succession	
	Coefficient	t-statistic	Coefficient	t-statistic
Intercept	0.03651	0.31	-0.43359***	-3.55
<i>Early Years</i> <sub>it</sub>	-0.04331	-0.67	-0.09345*	-1.68
<i>MVE</i> <sub>it-1</sub>	-0.02667*	-1.82	0.0166	1.14
<i>MTB</i> <sub>it-1</sub>	-0.0006	-1.54	0.00363***	6.29
<i>Leverage</i> <sub>it-1</sub>	-0.35748**	-1.96	0.30407***	3.21
<i>Sale</i> <sub>it-1</sub>	0.12976***	3.56	0.08117***	3.1
<i>ROA</i> <sub>it</sub>	-0.24018*	-1.81	0.0943	0.4
<i>Adj. R</i> <sup>2</sup>	0.09		0.09	
Observations	235		489	

\*\*\*, \*\*, \* indicate significance level at the 0.01, 0.05, and 0.1 respectively. *Abnormal Discretionary expenses*<sub>it</sub> is estimated as the residual of the discretionary expenses model of firm *i* at year *t*. *Early years*<sub>it</sub> is an indicator variable that equals one for first three years of management change. *MVE*<sub>it-1</sub> is the logarithm of market value of equity at the beginning of year *t*. *MTB*<sub>it-1</sub> is the market value of equity divided by the book value of equity at the beginning of year *t*. *Leverage*<sub>it</sub> is total debt divided by total assets at the beginning of year *t*. *ROA*<sub>it</sub> is earnings before extraordinary items in year *t* scaled by total assets at year *t-1*. *Sale*<sub>it-1</sub> is sale scaled by asset in year *t-1*.

**Table 4 Panel A**Dependent Variable: Discretionary Accruals<sub>it</sub>

	Coefficient	t-statistic
Intercept	0.1283***	3.49
<i>Early Years</i> <sub>it</sub>	0.0394**	1.95
<i>Score</i> <sub>it</sub>	0.0294	1.45
<i>Early Years</i> <sub>it</sub> * <i>Score</i> <sub>it</sub>	-0.064**	-1.92
<i>Score</i> <sub>it</sub>	0.0123	0.4
<i>Later Years</i> <sub>it</sub> * <i>Score</i> <sub>it</sub>	-0.074	-1.45
<i>MVE</i> <sub>it-1</sub>	-0.014***	-3.15
<i>MTB</i> <sub>it-1</sub>	0.0003*	1.99
<i>Litigation</i> <sub>it</sub>	0.0222	1.24
<i>Leverage</i> <sub>it-1</sub>	-0.108***	-3.86
<i>ROA</i> <sub>it</sub>	-0.042	-0.75
<i>Loss</i> <sub>it</sub>	-0.103***	-5.02
<i>PPE</i> <sub>it-1</sub>	0.1207***	6.81
<i>CFO</i> <sub>it</sub>	-0.814***	-9.68
F value	16.96	
Observation	602	

\*\*\*,\*\*, \* indicate significance level at the 0.01, 0.05, and 0.1 respectively. *Abnormal Discretionary accruals*<sub>it</sub> is estimated as the residual of the discretionary accruals model of firm *i* at year *t*. *Early years*<sub>it</sub> is an indicator variable that equals one for first three years after management change. *Later years*<sub>it</sub> is an indicator variable that equals one for prior year of management change. *Score*<sub>it</sub> is an indicator variable that equals one if the Score is greater than 6. *MVE*<sub>it-1</sub> is the logarithm of market value of equity at the beginning of year *t*. *MTB*<sub>it-1</sub> is the market value of equity divided by the book value of equity at the beginning of year *t*. *Litigation*<sub>it</sub> is one if the firm is in high litigation industry (SIC 2833 to 2836, 3570 to 3577, 3600 to 3674, 5200 to 5961, and 7370 to 7374). *Leverage*<sub>it-1</sub> is total debt divided by total assets at the beginning of year *t*. *ROA*<sub>it</sub> is earnings before extraordinary items in year *t* scaled by total assets at year *t-1*. *PPE*<sub>it-1</sub> is property plant and equipment scaled by asset in the year *t-1*. *Loss*<sub>it</sub> indicates one if net income is below zero in year *t*. *CFO*<sub>it</sub> is cash flow from operation in the year *t* scaled by asset in the year *t-1*

**Table 4 Panel B**Dependent Variable: Abnormal Discretionary Expenses<sub>it</sub>

	Coefficient	t-statistic
Intercept	-0.2404***	-2.57
<i>Early Years</i> <sub>it</sub>	-0.1053**	-1.9
<i>Later Years</i> <sub>it</sub>	-0.0429	-0.65
<i>Score</i> <sub>it</sub>	0.0872**	1.96
<i>Early Years</i> <sub>it</sub> * <i>Score</i> <sub>it</sub>	0.0459	0.5
<i>Later Years</i> <sub>it</sub> * <i>Score</i> <sub>it</sub>	-0.0317	-0.3
<i>MVE</i> <sub>it-1</sub>	-0.0005	-0.04
<i>MTB</i> <sub>it-1</sub>	0.0009***	2.61
<i>Leverage</i> <sub>it-1</sub>	0.1419*	1.79
<i>Sale</i> <sub>it-1</sub>	0.0801***	3.68
<i>ROA</i> <sub>it</sub>	-0.2027	-1.57
F value	4.00	
Observation	724	

\*\*\*, \*\*, \* indicate significance level at the 0.01, 0.05, and 0.1 respectively. *Abnormal Discretionary expenses*<sub>it</sub> is estimated as the residual of the discretionary expenses model of firm *i* at year *t*. *Early years*<sub>it</sub> is an indicator variable that equals one for first three years after management change. *Later years*<sub>it</sub> is an indicator variable that equals one for prior year of management change. *Score*<sub>it</sub> is an indicator variable that equals one if the Score is greater than 6. *MVE*<sub>it-1</sub> is the logarithm of market value of equity at the beginning of year *t*. *MTB*<sub>it-1</sub> is the market value of equity divided by the book value of equity at the beginning of year *t*. *Leverage*<sub>it-1</sub> is total debt divided by total assets at the beginning of year *t*. *ROA*<sub>it</sub> is earnings before extraordinary items in year *t* scaled by total assets at year *t-1*. *Sale*<sub>it-1</sub> is sale scaled by asset in year *t-1*.

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## 국문초록

# 전임자의 비자발적 사임이 새로 임명된 경영자의 이익 조정에 미치는 영향

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송민철

본 연구는 최고 경영자의 비자발적 사임이 이후 임명되는 새 경영자의 이익 조정에 어떠한 영향을 주는지에 대해 다루고 있다. 선행 연구에 따르면 최고 경영자의 재임기간 중 초기 이익 조정이 말기 이익조정보다 크다는 것을 밝혔다. 본 연구는 이러한 경향이 전임자의 자발적 사임과 비자발적 사임에 따라서 달라지는지 분석하였고 그 결과 비자발적 사임의 경우 재임 초기와 말기의 이익 조정 차이가 사라지는 것을 발견하였다. 특히, 비자발적으로 사임된 경영자 이후 새로 임명된 최고 경영자가 재임 초기에 이익 조정을 주저함으로써 초기와 말기의 조정 차이가 줄어드는 것을 발견하였다.

**주요어:** 이익 조정, 경영자, 비자발적 사임, 사임 유형, 재임 기간

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