THE IMPACT OF RESUMPTION OF FORMER TOP EXECUTIVES ON STOCK PRICES: AN EVENT STUDY APPROACH

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Abstract. This study explored the impact of resumption of former top executives on stock prices based on market model for the listed corporations in Taiwan stock market. Top executives nowadays confront great challenges in acquiring new corporate accounts to meet agreed targets and drive rapid, profitable growth. Accordingly, corporations commonly decide to reinstate former top executives since their managerial experience is expected to improve corporate performance. The aim of this study is to provide practical guidelines for companies that are considering such decisions and favorable information that can help investors to adjust their portfolios in response to such potential decisions.

1. Introduction

A top executive who resume his or her former office will find that completely reinventing the company and re-injecting new blood is a major challenge. When their business environment is changing dramatically, enterprises are likely to change top executives in response to particular challenges, to achieve market dominance or to face the emergence of new competitors. However, newly appointed top executives commonly lead companies into trouble because of poor short-term performance and improper decision-making. As a result, a company may return a former top executive to his position.

Although a veteran of a company may be well-versed in the overall operating profile of a company and identify problems, they tend to be conservative and are not good at exploiting new technologies for innovation (Mian 2001). In many cases, the performance of top executives who resume their former offices is mixed: the stock price of the world's largest coffee chain store, Starbucks, fell drastically when its founder Schultz resumed his former position. However, Dell reinvented the business model of Dell Inc.; and Apple's top executives Steve Jobs has been called the most successful resuming top

executives, thanks to the his creative revolution of the company's business strategy. The capabilities of one man, however, cannot produce more than the spirit of the team under him can support. Causes of success are worthy of exploration. Some top executives may be not willing to revolutionize the companies that they helped to develop when they held their position previously. The successful example of Apple Computer's designing stunning new technological products, such as the iPod and the iPhone demonstrates the outstanding creativity of Steve Jobs and excellently organized teamwork.

Topics worthy of discussion include business performance before the announcement of the replacement of the top executives, the time between announcement and his resuming his role, and whether the staff of the firm and the familiarity of the new top executives with the business's operations will support radical changes. Whether the replacement of top executives is good or bad for companies can be observed by the response of the stock price of the firm market. Additionally, the company's business performance upon the announcement that the top executives will be replaced substantially affects the average cumulative abnormal returns. The newly-appointed top executives has no significant effect on market reaction (e.g. Warner *et al.* 1988; Lubatkin *et al.* 1989; Barro, J., Barro, R. 1990; Ball, Torous 1998; DeFonda, Park 1999). Some scholars believe that new top executives do less well than expected in terms of business revenue. Puffer and Weintrop (1991) argued that the revenue of a business following the appointment of new top executives is generally lower than expected by analysts.

The significant effect of the resumption of duty by top executives on the value of a company is evident*,* as is the inadequacy of studies of the resumption of duty by former top executives in Taiwan. According to the relevant regulations, the replacement of top executives is important information that should be publicly disclosed on the platform of the information system of Taiwan's Stock Exchange within a time limit.

2. Literature review

Top executives who perform poorly are replaced by those with better capabilities to enhance corporate performance (Kaplan 1994; Goyal, Park 2002; Alas 2008; Vallejo-Martos 2011). The separation of ownership from management creates the agency problem: top executives make decisions and behave in a manner that maximizes their personal interest rather than the wealth of shareholders. To address the agency problem, a company normally limits the self-interested behaviors of its top executives by urging them to sign contracts with external shareholders. They have a significant impact on business performance and the way in which decisions are made at their companies. Theoretically, top executives, as their title suggests, are those who hold the most important posts in an organization; guide the overall operations of the company, such as replacing other employees in important posts; set business strategy, and make major decisions. Supporters of this theory believe that companies select experienced experts as leaders to improve organizational performance (Borokhovich *et al.* 1996; Lausten 2002; Ginevičius, Vaitkūnaitė 2006; Strandskov 2006; Curado, Manica 2010).

The theory "Ritual Scapegoating Theory". Its adherents believe that the replacement of leadership has no impact on business performance; the replaced leader is a scapegoat for poor business performance (Kang, Shivdasani 1995; Nelson 2005). In studies of the relationship between the replacement of top executives and business performance, the theory is called the "common-sense theory". An organization changes leadership when performance is poor, and so the vicious circle is set in motion (Parrino 1997; Conyon 1998; Farrell, Whidbee 2002, 2003).

Owing to the changing environment and fierce market competition, the replacement of top executives, leadership styles, lengths of tenure and the organization of enterprises differ from those of the past (Marković 2008; Vallejo-Martos 2011). Top corporate executives must grasp the overall operations of an enterprise and its major decisions. The performance of executives who resume former offices should be evaluated against market expectations. Such top executives tend to have experience of numerous enterprises, and they must face many challenges and develop new perspectives to drive change. If the enterprise is insufficiently competitive and lacks capacity, veterans of the firm cannot help. The return of top executives may facilita the improvement of business efficiency. The replacement of top executives somewhat affects the transfer of power and organizational changes. As well as the top executives, environmental factors, the age, size and performance of the organization, employee support and coordination are also major considerations. A change of top executives can be regarded as an enterprise. However, studies of the impact of the resumption of offices by top executives on business performance are few and the topic is overdue for exploration. Like the coordination of the external and internal environments of an organization and the benchmarks improve business performance. Leadership greatly affects the enterprise.

This study investigates the impact of the return of former top executives on the stock prices of their enterprises; reviews the reactions of the stock prices, and discusses the value of the information that top executives are to resume their offices, using the event study methodology. The effect of the disclosure of information regarding the resumption of old offices by top executives of publicly listed electronics companies in Taiwan is examined. Until now, most domestic discussions in the field have focused on such topics as changes of management, abnormal factors and the shareholder wealth effects without consideration of the impact of top executives' resumption on the performance of stock price of their enterprises.

3. Research method and data description

3.1. Sample period and data sources

The research period of this study starts during 1995–2009, which comprised 21 resumptions of duty by board directors and 50 by general managers. Most of the data concerning informational disclosures by the sample companies was downloaded from the "Public Information Observation Website" of Taiwan Stock Exchange. The purpose of this study aims to investigate the impact of top executives' resuming offices on the stock prices of their companies. Therefore, resumptions of duty by top executives were

grouped into entrepreneurial resumptions of duty and general resumptions of duty. The resumption of duty by a top executive who is a founder of the company is an entrepreneurial resumption of duty. The raising of a general employee to a top executive office is regarded as the general resumption of duty. To provide more detailed analysis, these two of events were further categorized into the external and internal resumption of duty. The resumption of a top executive position by a company founder who has served in other companies after leaving the present company is an external resumption of duty. The transfer of a founder who was temporarily working in a particular department of a company back to a top executive position is an internal resumption of duty.

Company stock price data are downloaded from the "Taiwan New Economic Journal (TEJ)" database. The purpose of this article was to determine whether entrepreneurial resumption of duty and general resumption of duty affect stock prices and rapidly become public information. The impacts of the resumption of duty by top executives on stock prices are also explored. External resumption of duty refers to the situation in which a former top executive who has worked for other companies resumes his position in the company of interest. In the following, we define five terms used in event study methodology and determine sample selection principles, research period and data sources.

The observation period ran 121 trading days from the 105 trading days before the event date to the 15 trading days after the event date. The date of resumption of duty by a top executive is denoted as No. 0 transaction day, or "0". No. *t* transaction day before the resumption of duty by a top executive is represented by "–t" while No. *t* transaction day after the resumption of duty by a top executive is represented by "+t".

3.2. Research method

This study adopted the event study methodology (Brown, Warner 1980; Corhay, Tourani 1994; Pantzalis *et al.* 2000; Chen, Su 2010; Lai *et al.* 2010; Wang, Chuang 2010) to analyze the impact of resumption of top executives on stock price before and after the announcement of such event. This method assumes that the market quickly and sufficiently responds to public information whenever specific events happen. Namely, when a company releases important information, its stock price quickly and sufficiently reflects this information. In addition, we also explored whether such event would lead to any abnormal return (AR) for the company.

3.2.1. Market model

The widely-used market model is utilized to examine the impact of information about the resumption of duty by a former top executive on stock price, and such information can result in AR (Wang *et al.* 2010; Yang *et al.* 2010). The market model in event study analysis was as follows.

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}, \tag{1}$$

where R_{it} and R_{mt} respectively denote the returns of the stock *i* and market in period *t*; α_i is the intercept term; β_i measures the system risk of the stock *i,* and ε_{it} is the error term.

3.2.2. AR (Abnormal Return)

The event study methodology was utilized to identify the existence of abnormal return, which can be calculated by subtracting expected returns from actual returns. The equation is as follows:

$$AR_{it} = R_{it} - E(\hat{R}_{it}),$$
(2)

where AR_{it} denotes the abnormal return of stock i in period t; R_{it} is the actual returns of company i in period t, and $E(\hat{R}_{it})$ is the expected returns of stock i in period t.

3.2.3. CAR (Cumulative Abnormal Return)

As AR_{it} is subject to the impact of error, the average of all cumulative abnormal returns after the event happened was used to reduce the impact of errors on the stock returns. The average AR is defined as,

$$AAR_t = \frac{1}{N} \sum_{i-1}^{N} AR_{it},$$
(3)

where the average AR from the specific date τ_1 of the event period to τ_2 th is added to obtain the CAR of that period; namely, the CAR of a total of τ days ($\tau = \tau_2 - \tau_1$) from the τ_1 th to the τ_2 th event date, and the equation is as follows:

$$CAR_t(\tau_1, \tau_2) = \frac{1}{N} \sum_{t=\tau_1}^{\tau_2} AAR_{it}.$$
(4)

The average AR and CAR can improve AR, in particular, the testing capabilities of the impacts on stock prices for specific events.

4. Empirical result

4.1. Abnormal Returns (AR) upon return of Chairman and General Manager

Table 1 shows the results on the behavior of AR and its t-test statistics for Taiwan's listed electronics stock on event window after the announcement dates of the resumption of top executives. For the case of the return of Chairman, the 15th day (t = 1.9363) is associated with significantly positive AR. Additionally, in the 15 days following the event day, the 8th and the 10th days are associated with significantly negative AR. These evidences suggest the return of a Chairman has a significantly positive effect on stock prices before the event window because information is exposed to the public in advance. This result indicates that information may leak out before the announcement dates.

Upon the case of the return of a General Manager, in the 15 days before the event day, the 8th and 13th days are associated with significantly negative AR. In the 15 days following the event day, the first day is associated with a significantly negative AR, while the 4th and 9th are associated with significantly positive AR. These evidences suggest that investors respond differently before and after the announcement of the return of General Manager, which does not necessarily lead to a desirable impact on the market value of the company.

Table 1. Results of AR on resumptions of Chairman and General Manager

Window	Chairman		General Manager	
	AR	*t*-test	*AR*	*t*-test
−15	**0.989**	**1.9363***	−0.053	−0.134
−14	−0.298	−0.584	−0.169	−0.426
−13	−0.498	−0.975	**−0.683**	**−1.726***
−12	−0.127	−0.249	−0.338	−0.853
−11	−0.264	−0.516	0.195	0.492
−10	−0.104	−0.203	−0.150	−0.379
−9	0.067	0.139	−0.240	−0.606
−8	0.013	0.025	**−0.676**	**−1.707***
−7	−0.337	−0.660	−0.275	−0.695
−6	−0.454	−0.888	−0.280	−0.708
−5	−0.029	−0.056	−0.103	−0.261
−4	−0.043	−0.084	−0.515	−1.301
−3	0.751	1.471	−0.119	−0.301
−2	−0.230	−0.450	0.054	0.135
−1	−0.383	−0.750	−0.4184	−1.057
0	−0.732	−1.434	0.037	0.094
1	−0.313	−0.613	**−0.774**	**−1.956***
2	0.020	0.039	−0.065	−0.164
3	0.502	0.983	0.049	0.124
4	0.168	0.33	**0.782**	**1.976***
5	−0.298	−0.583	−0.202	−0.510
6	0.107	0.210	−0.291	−0.736
7	−0.195	−0.382	−0.325	−0.822
8	**−1.174**	**−2.300***	0.436	1.103
9	0.093	0.183	**0.664**	**1.677***
10	**−0.892**	**−1.747***	0.126	0.319
11	0.230	0.451	0.326	0.823
12	−0.768	−1.505	−0.560	−1.414
13	−0.074	−0.144	0.589	1.489
14	−0.501	−0.981	−0.114	−0.288
15	−0.231	−0.452	−0.082	−0.208

Note: * denotes statistical significance at the 10% level.

To summarize, as indicated by the empirical results of the returns of Chairman and General Manager, we can observe that information regarding their returns may leak out before the announcement dates so that investors are enable to respond to this information in advance. Accordingly, abnormal returns occur. Also, around the announcement dates, different investors respond differently. Generally, the return of top executives does not significantly influence investors' decisions. Also, negative abnormal returns can be observed regardless of the return of a Chairman and General Manager. A comparison of results concerning abnormal returns associated with returns of the Chairman and General Manager reveal that information regarding their returns may be leaked before the announcement date, so investors respond to stock prices in advance.

Many studies pay attention to explore the relationship between top executives turnover and corporate performance, and ignore the returning of top executive. However, the empirical results of this study indicate that the returning of top executives does not necessarily result in improved performance of stock price, provided warning for investors that there is no need to overestimate the reformative impact of returning of top executives.

4.2. Cumulative Abnormal Returns (CAR) upon return of Chairman and General Manager

Upon the return of a Chairman as shown in Table 2, the average cumulative abnormal returns are positive for four days (–15th ~ –12th) before the announcement date but turn negative after the announcement date until the 12th day. The response of the return of top executives is continuously negative after the event day. Moreover, in the 15 days before the event day, the 15th day is associated with significantly positive CAR. In 15 days following the event day, the 14th and 15th are associated with significantly negative CAR. The return of a Chairman has a significantly positive effect on stock prices before the event window as information is provided to the public in advance. Upon the return of a General Manager, in the 15 days before the event day, the average cumulative abnormal returns are negative before and after the announcement date, in which the CAR is significant negative from –8th to 10th days.

The results for CAR upon the return of a Chairman and General Manager are compared. They demonstrate that the news of the return of a Chairman is likely to leak before the announcement date and investors respond to stock prices in advance. Accordingly, abnormal returns are identified. However, investors react negatively before and after the date of an announcement of the return of top executives, and particularly of the return of a General Manager. Therefore, the return of these officers does not bring about better prospects for the company.

Table 2. Results of CAR on resumptions of Chairman and General Manager

Window	Chairman		General Managers	
	CAR	*t*-test	*CAR*	*t*-test
−15	**0.989**	**1.936***	−0.053	−0.134
−14	0.690	0.956	−0.222	−0.396
−13	0.192	0.217	−0.904	−1.320
−12	0.065	0.064	−1.242	−1.569
−11	−0.199	−0.174	−1.047	−1.184
−10	−0.302	−0.242	−1.197	−1.235
−9	−0.236	−0.174	−1.437	−1.373
−8	−0.223	−0.154	**−2.113**	**−1.888***
−7	−0.560	−0.365	**−2.388**	**−2.012***
−6	−1.013	−0.628	**−2.668**	**−2.133***
−5	−1.042	−0.615	**−2.772**	**−2.112***
−4	−1.085	−0.613	**−3.286**	**−2.398***
−3	−0.333	−0.181	**−3.405**	**−2.387***
−2	−0.563	−0.295	**−3.352**	**−2.264***
−1	−0.946	−0.479	**−3.770**	**−2.460***
0	−1.678	−0.822	**−3.733**	**−2.359***
1	−1.991	−0.946	**−4.507**	**−2.763***
2	−1.971	−0.910	**−4.571**	**−2.723***
3	−1.470	−0.661	**−4.522**	**−2.622***
4	−1.302	−0.570	**−3.741**	**−2.114***
5	−1.599	−0.684	**−3.942**	**−2.174***
6	−1.492	−0.623	**−4.233**	**−2.281***
7	−1.687	−0.689	**−4.559**	**−2.403***
8	−2.861	−1.144	**−4.123**	**−2.127***
9	−2.768	−1.084	**−3.459**	**−1.748***
10	−3.660	−1.406	**−3.333**	**−1.652***
11	−3.430	−1.293	−3.007	−1.463
12	−4.198	−1.554	**−3.567**	**−1.704***
13	−4.272	−1.554	−2.977	−1.397
14	**−4.772**	**−1.707***	−3.092	−1.427
15	**−3.174**	**−1.760***	−3.174	−1.441

Note: * denotes statistical significance at the 10% level.

5. Conclusion

This study examines the impact of the returning of top executives on average cumulative abnormal returns. The results demonstrate that the return of top executives has a significantly negative impact on market value. The decision to bring back top executives does not necessarily result in improved performance of stock price. Companies are therefore advised cautiously to evaluate whether they should change their top executives to avoid fluctuations in stock price and damage to the interests of their investors. The return of top executives is not expected to have a positive effect on stock price.

Given the limit of availability for empirical data, examination on the personal attributes of the returning top executives is not conducting. As an example, whether top executives previously stepped down from that office voluntarily or non-voluntarily may result in different outcomes upon his return, and this fact may represent a limitation on the findings of this study. Meanwhile, the ethics of leadership for top executives might influence our findings.

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