

The Market for CEOs

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CEO-firm matching

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

This study

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

Results

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

Interpretation & implications

- Market not well described by models in which all skills are general and all firms choose from one unified pool
 - Candidate pool is small and differs across firms
 - To match the data: Firm-specific human capital and / or asymmetric learning (?)
 - Strong preference for current & former employees, board members
 - ASL needed to explain hiring of “connected outsiders”
 - Directors want to know the candidate (and vice versa)
- ⇒ Pay: rents to be shared, likely increase with firm size

Insiders vs. outsiders

All firms (1,256 CEO hires)

Internal promotion	External hire			
72%	28%			
	Former executive	Board member	Former executive or board member	True outsider
As % of all hires:	4.0%	7.4%	8.4%	19.6%

1993-1999 (418 CEO hires)

Internal promotion	External insider	Outsider
74%	7.7%	18.7%

2000-2006 (515 CEO hires)

Internal promotion	External insider	Outsider
70%	9.3%	21.0%

2007-2021 (323 CEO hires)

Internal promotion	External insider	Outsider
74%	7.7%	18.6%

Outsiders' connections

Connections between boards and new CEO hires

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

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

Sources of outsiders

Outsiders (246 hires)

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

External insiders (106 hires)

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

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

Origin firms of raided hires

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

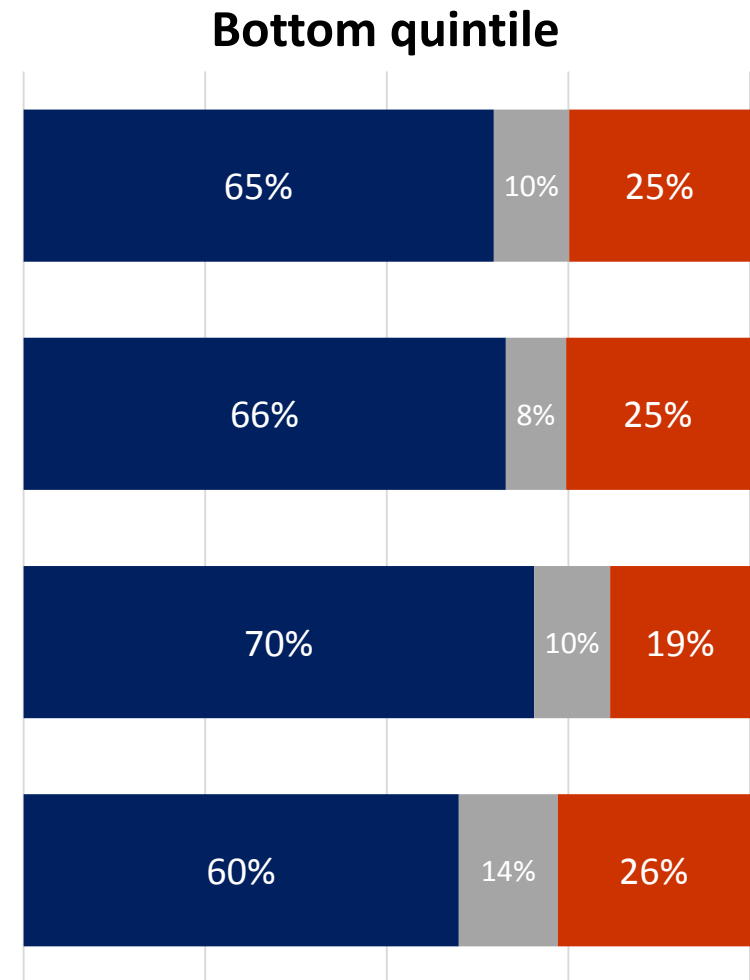
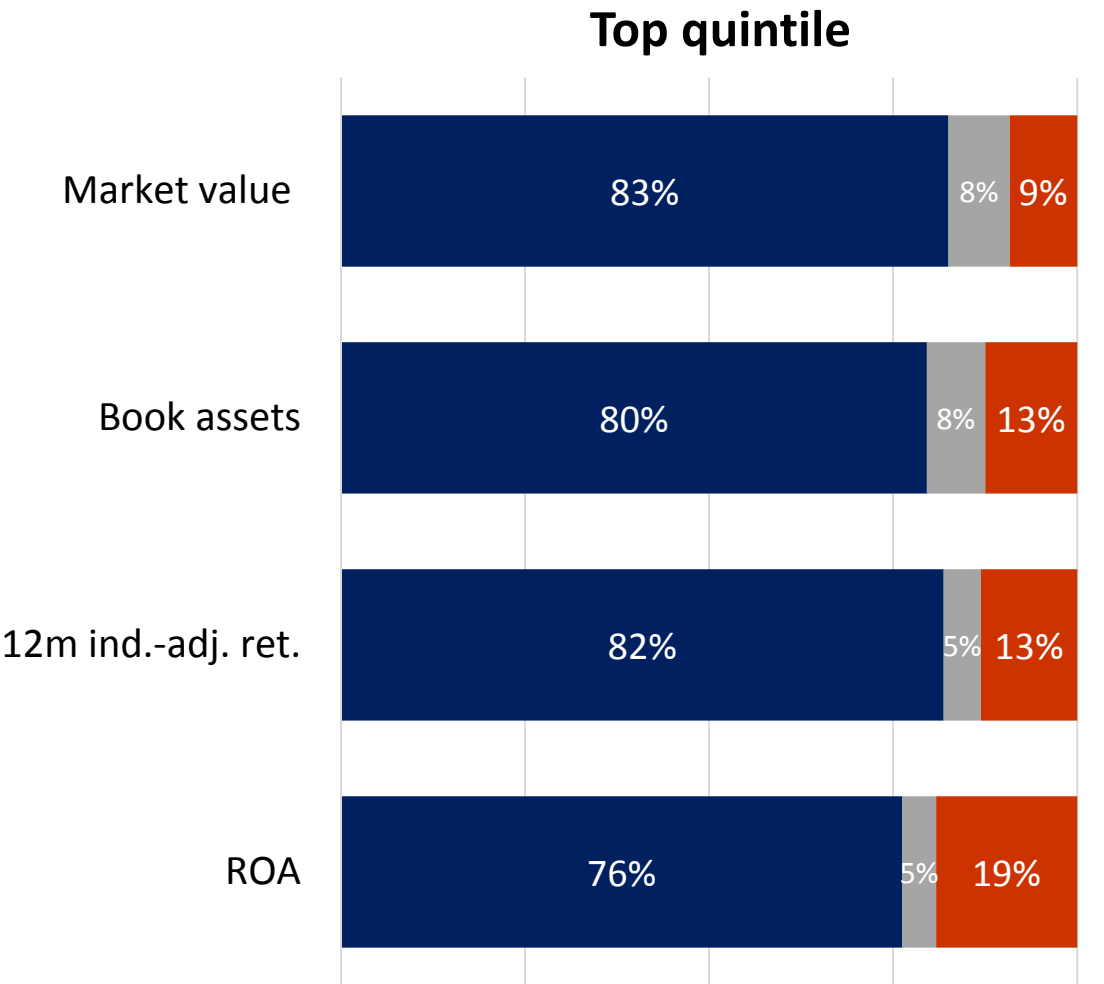
Hiring firms

By insiders vs. outsiders

	Internal promotion		External insider		Outsider	
	Mean	Median	Mean	Median	Mean	Median
Market value	27,112	11,528	21,745	9,678	15,532	9,397
Book assets	18,557	8,511	17,323	6,619	12,449	6,771
12m ind.-adj. return	0.09	0.00	-1.66	-1.20	-1.09	-0.37
36m ind.-adj. return	0.11	0.00	-0.81	-0.62	-0.39	-0.40
ROA	0.05	0.05	0.01	0.03	0.04	0.04

Hiring firms

By insiders vs. outsiders



■ Internal promotion ■ External insider ■ Outsider

Hiring firms:

By source of outsider hire

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

New CEO pay

By insider vs. outsider

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

By source of outsider hire

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

Conclusions

- Firms hire CEOs they are already familiar with
 - Current or former executives, current or former board members, executives their directors have worked with
 - There is little reallocation of CEOs across firms
- ⇒ Suggests:
- Firm-specific human capital & personal contacts are of first-order importance
 - The effective hiring pool differs across firms and is small
 - Maybe: rising CEO pay might be explained by CEOs sharing increasing rents from firm-specific human capital