Salomo, Sören; Leker, Jens

Working Paper
The "financial bath" hypothesis: An empirical investigation

Manuskripte aus den Instituten für Betriebswirtschaftslehre der Universität Kiel, No. 448

Provided in Cooperation with:
Christian-Albrechts-University of Kiel, Institute of Business Administration

Suggested Citation: Salomo, Sören; Leker, Jens (1997) : The "financial bath" hypothesis: An empirical investigation, Manuskripte aus den Instituten für Betriebswirtschaftslehre der Universität Kiel, No. 448, Universität Kiel, Institut für Betriebswirtschaftslehre, Kiel

This Version is available at:
http://hdl.handle.net/10419/149065

Terms of use:
Documents in EconStor may be saved and copied for your personal and scholarly purposes.
You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.
If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.
Manuskripte
aus den
Instituten für Betriebswirtschaftslehre
der Universität Kiel

Nr. 448

Sören Salomo und Jens Leker

The „Financial Bath“ Hypothesis: An Empirical Investigation
Nr. 448

Sören Salomo und Jens Leker

The „Financial Bath“ Hypothesis:
An Empirical Investigation
The „Financial Bath“ Hypothesis: An Empirical Investigation

This article examines the influence of CEO changes in large German companies manifested in their financial statements during three defined phases of the turnover process. It is shown that the conflicting results in previous research might have stemmed from not differing among turnover reasons. Companies experiencing an involuntary change of CEO undergo a different evolution of performance than companies whose CEOs have changed voluntarily or for reasons like mandatory retirement or death.
INTRODUCTION

On the 18th of December 1993, a leading German newspaper reported the firing of Heinz Schimmelbusch, CEO of the Metallgesellschaft AG, and his succession by the “experienced troubleshooter” Kajo Neukirchen.

Prior to this incident the Metallgesellschaft’s difficult economic situation had already been discussed publicly. A 1991/92 business year dividend was only payable because the negative operating return was made up for by extraordinary major asset sales. Schimmelbusch had announced a zero dividend payment for the period 1992/93. Serious liquidity problems - the results of time deposits due for commodity future-deals with already exhausted credit lines and other risky commodity exchange deals - culminated finally in the firing of CEO Schimmelbusch.

His successor, Kajo Neukirchen, was appointed especially at the behest of the banks represented on the company’s board. His first act in office was to correct the profit stated in the preliminary balance sheet drawn up by his predecessor. Instead of the losses of 347 Mill. DM previously announced, additional reckoning of future losses and doubtful debts, calculations of extraordinary depreciations and other losses deteriorated the stated result to a total loss of 1.8 Bill. DM. A capital increase was approved by a special shareholders meeting in February 1994, where Neukirchen outlined his planned turnaround strategy. The initial steps in the turnaround would be drastic cost reduction activity in operating, a diminished investment program and efforts to reduce trade receivables by 20%. The second step of his redressment program would involve strategic reorientation and organizational changes.

As seen in this introductory case study, a company’s economic situation is subject to alteration during the process of CEO-turnover. The general research question - which is the focus of our study - deals with the effects of CEO turnover as revealed in the published
balance sheets. It is argued that first differentiating among turnover reasons, followed by a
subsequent analysis of company performance is an easy way of determining turnover effects.
With regard to large German industrial companies, it may be shown that the CEO exerts a
significant influence on the published economic situation of his company. The direction of
this influence is then modified according to the specific situation during the period of
change.

PRIOR RESEARCH

Prior research has focused mainly on two different aspects of the turnover situation. A
number of the studies have examined the reasons behind replacing the corporate top
executive, with the change being an endogenous variable. Others have concentrated their
research activity on the effects CEO turnover has on the organizational output. Primarily
large corporations\(^1\) or professional sport teams (Gamson & Scotch, 1964; Grusky, 1969;
Eitzen & Yetman, 1972; Allen et al., 1979; Brown 1982) form the basis from which
samples have been drawn.

The change in the position of the CEO is usually measured on a nominal scale (change:
yes/no) and rather rarely on a cardinal scale (tenure of office, for example). Few authors
specify the change in terms of a typology of the new CEO. They tend to separate insiders
from outsiders\(^2\) or achieve a typology by measuring one's position of power within the
organization. Only very few studies differentiate among reasons for the turnover, such as
voluntary versus involuntary changing of the CEO.

Examining the age of the incumbent CEO in relation to the regular age of retirement has
been a simple way to measure the regularity of turnover (Poensgen & Lukas, 1982). Te
Wildt goes further by trying to eliminate all not-performance-related changes as opposed to
turnovers defined in the abovementioned way as being irregular (1996: 60). As a source of
information he concentrates on the published annual balance sheet. A similar approach is
chosen by James and Soref who design a turnover classification using published information about the change. But obtaining sufficient and reliable information proves to be very difficult. They admit that correct classification is often hindered due to the information regarding turnover reasons not being straightforward:

“For one thing, firings of the top management personnel are never called firings. Chief executives and companies usually prefer to treat the matter delicately; hence, generally “resignations” are accepted, or “early retirements” are taken, but firings do not occur” (1981: 4).

The studies dedicated to determining the factors of influence on the turnover show that performance explains a great part of the probability of change (Eitzen & Yetman, 1972; Weiner & Mahoney, 1989). A decrease in performance increases the probability of subsequent CEO turnover (Osborne, 1981; Te Wildt 1996). The degree of accuracy, however, in this assumption depends upon the specific situation. Performance-related turnovers are generally observed in those cases where CEOs leave before normal retirement (Coughlan & Schmidt, 1985). If the top executive remains in office until normal retirement age, performance is not an explanation for the change in office. If the CEO is able to exercise extraordinary power, for example due to his position as a major stock holder, a change in office is observable most especially during periods of good performance (Allen & Panian, 1982). Implicitly, this provides further evidence concerning the influence a control or audit committee has on the replacement-process. Schrader and Lütje point in the same direction. Their results indicate that small and owner controlled companies change their chief executive officer relatively more often for reasons other than retirement (1995: 488). Furthermore an organizations’ ability to cope with its own interdependence proves to exert great influence on CEO turnover (Salancik et al., 1980). The change in the top executive position is a reaction to changing requirements which the CEO must meet.
Prior research on the effects of a change in the top executive position shows conflicting results. Both improvement and deterioration of performance, or even that it has no significant influence, is connected to CEO turnover. Differentiating, however, among types of new CEOs (i.e. insider/outsider) appears to clarify the direction of influence. If the successor is an insider, performance stabilizes; an actual improvement of the situation only occurs if the succession is by an outsider (Helmich & Brown, 1972; Lubatkin et al., 1989). It might be reasoned that identifying CEO types leads to a better explanation of performance development. Carlsons results point indeed in that direction, showing that outsiders are more often chosen over insiders in a situation where there is a strong demand for change (1962: 226). Identification of the turnover reasons should provide a more consistent explanation of succession effects.

**REASONS FOR CEO TURNOVER**

In order to create a typology for turnover reasons, we follow the framework suggested by Schrader/Lütje and identify three main species of dismissal: the unavoidable change without any person actively involved, the “voluntary dismissal” with the CEO himself choosing to leave the organization, and finally the “involuntary” CEO turnover – forcibly brought about by a controlling power within the organization (e.g. in the German case: the “Aufsichtsrat”). A similarly three-dimensional definition of turnover reasons is offered by Price (1975: 33), who identifies “retirement”, “dismissal” and “resignation”.

Reasons for a change in the top executive position such as illness, death or even mandatory retirement at “normal” retirement age³ indicate a situation with no person actively determining the fact and date of change. If the dismissal is characterized as voluntary, the CEO is the driving force in the turnover decision. This would be the case in a situation of his or her opting for a leading board position in another company. In the relevant literature, a wide variety of different reasons are discussed concerning this kind of succession (Bluedorn, 1982).
We define the involuntary change as a forced replacement of the CEO. The controlling body - normally the board - is the acting power in this process. The CEO is subject to supervision by the board. Performance serves as the primary indicator for measurement of the CEO's activities. It is his responsibility to fulfill the performance requirements set by the board (Lewin & Wolf, 1974; Crain et al., 1977; James & Soref, 1981; Schwarz & Menon, 1985; Fredrickson et al., 1988; Comte & Mihal, 1990). The CEO is held accountable for insufficient performance, and he must then leave the organization as a consequence thereof (Salancik & Pfeffer, 1980; Comte & Mihal, 1990; Puffer & Weintrop, 1991).

Parallel to performance orientation other reasons are discussed as well. Turnover at the CEO-level is often seen as a scapegoating process (Gamson & Scotch, 1964). Replacement of the top executive functions as a symbolic action to send a positive signal to the external world indicating future improvements. Reasons for turnover that stem from personal problems between people might offer some additional explanation for the change. In each case, however, the supervising body is the driving force behind the change process.

**THE INVOLUNTARY CEO TURNOVER**

This study focuses on that particular type of involuntary turnover which is often crisis-related and occurs unexpected by the public. The main research question concentrates on the amount of influence the CEO has on the economic situation of the company. Does the CEO, during the succession process, interfere in accounting affairs in consideration of his or her own ends?

The influence that the incumbent and the new CEOs may have on accounting has previously been addressed by only a few and only American studies. The potential and direction of influence is discussed in some controversy (Moore, 1973; Chen & Lee, 1990; Murphy &
Zimmermann, 1993; LaSalle et al., 1993). As we have already shown in the general performance/succession discussion, a separation among reasons for turnover should clarify the relationship. A CEO who leaves because of the mandatory pension plan and his successor in office will obviously be considering other aims than persons who are involved in a crisis-laden turnover. In the case of a corporate crisis, in particular, a considerable amount of balance sheet policy is sure to occur. And the CEO, as the primary promoter of balance sheet policy, certainly has a large interest in pursuing individual ends in this situation.

With regards to determining the CEO's potential influence, Murphy/Zimmermann (1993: 310) emphasize that it is important to identify exactly who is responsible for drawing up the balance sheet. A top executive entering the company at the beginning of a new business year might have decisive influence on the balance sheet presented for the previous year.

Obviously the period of examination must be adjusted in terms of the date of succession. Various expectations concerning the accounting policy in each business year are formulated according to the different conditions prevalent during the succession process.

For our period to be examined we chose to study the two years just prior to the CEO turnover, the first year immediately following the change (influenced by the incoming CEO), and the next two years under his supervision. The analysis thus spans a period of five years, which can in turn be separated into three phases:

1. **The downturn:** The final two years (t₂, t₁) under the influence of the CEO who will then leave.

2. **The adjustment:** The initial period, from a month to a maximum of a year, (t₀) under supervision of the incoming CEO.
3. Consolidation: The second and third years \((t_1, t_2)\) under the "new" CEO.

The annual balance sheets published for phase 1 are affected by the CEO who is to leave later on. Developments in the economic situation of the company culminate in the forcible dismissal of the top executive responsible, due to "differences regarding the corporate policy". The involuntary change is most likely the result of the company being confronted with some crisis situation. The supervising board and the CEO are of different opinions as to how to direct corporate policy in order to solve the difficulties. The CEO is blamed for the unsatisfactory results and must leave his position. The board views the replacement of the incumbent top executive as a precondition for a successful turnaround (Hofer, 1980).

The annual balance sheet report on the year's results is the board's primary source of information. To secure his position as CEO, it is possible that the executive may influence the report by means of discretionary accounting decisions in his favor. It is in his interest to employ all income increasing means at his disposal in order to reduce visibility of the crisis in the company report (Hauschildt, 1977).

Phase 2, from the turnover itself until the first company report under supervision of the incoming CEO, we denote as the period of adjustment. The succeeding CEO undertakes this top management position intending to initiate a turnaround. There are two factors, however, that might hinder a CEO change from resulting in an *immediate* improvement:

1. It can be beneficial to the new CEO to reverse all income-reducing accounting decisions made by his predecessor, while also painting the economic situation as pessimistically as possible. The company then experiences what is commonly known as the "financial bath" after a CEO turnover (Copeland & Moore, 1972). This describes a shortfall of company results due to a). the regular increases in expenses and provisions following a change in the management, and in addition b). some further expenses and provisions – in terms of amount and time not always essential – which are incurred by the
new head of the company. This situation, appearing to be a necessary evil, is not dangerous to the new CEO because it can be blamed on the old one. La Salle et al. (1996: 653) refer to this as the "blaming hypothesis". As a matter of fact, systematic undervaluation of a present situation creates a sound basis for future improvement - for which the new CEO is then held accountable. At the same time, the new management reduces the actual level of entitlement of the board (Hauschildt, 1977), making it easier to meet the anticipated results in the future.

2. Besides the above mentioned "influence" effects there are likely to be some "real" effects resulting from the change in management. A change in the CEO position normally induces fluctuation in the lower hierarchies as well, which would then result in increased expenses, e.g. due to severance payments (Gabarro, 1988). Reorganization and reorientation of company policy, especially when the change has come about because of differences on that issue, may cause additional pressure on results. Merely having a different view of things might well result in "real" effects in the company's economic situation, as Gonedes/Dopuch (1988: 188) argue.

Phase 2, with its disruptive effects on the company results, is then followed by phase 3 - the consolidation. If the incoming CEO really does increase expenses and provisions in his first year more than is necessary, the following years are however relieved of these burdens. A trend towards improved earnings should appear almost automatically (Moore, 1973).

Furthermore, it is obvious that having been in charge for some time it becomes increasingly more difficult to lay blame on the previous CEO. The new management is held ever more accountable for the company's performance. The requirements set by the supervising board must be fulfilled. After a tolerated or even expected decrease in income in phase 2, a positive trend in the earnings should now be visible. If the new CEO does not meet these expectations he, too, runs the risk of being dismissed.4
Aside from these rather technical reasons for income increase, CEO turnover might have some simple, real effects on the increase as well. In this case, the new management really does bring about a turnaround by choosing the right business policy, and/or turnaround is related to the positive motivational effects resulting from the new leadership.

**DATA**

The hypotheses noted above require the collection of data both from the companies changing their CEO as well as data regarding the change process itself. The primary source of companies is based on the German firms listed on the Frankfurt Stock Exchange, as compiled by the investment journal "Börse Online". We chose to limit the sample to the 274 companies in the industrial sphere. Restricting the sample to major limited companies makes external analysis of the published balance sheet possible. A listing on the stock exchange likewise creates greater public interest in the development of companies, and even internal information is then subject to discussion in the relevant press media. This adds to the amount of data available on the fluctuation in a top executive position.

This analysis concentrates on a six year period beginning in 1987. Because of the major changes in accounting standards resulting from the new law on accounting rules (Bilanzrichtliniengesetz) of 1987, a comparative analysis over time using data from previous years was not possible.

Each company in the sample was examined for a change in the chief executive position. Observations on CEO turnover were made possible on the basis of the (voluntary) mention of some of the companies’ management team compositions in their balance sheet. The reason for turnover on the CEO level was the issue of a questionnaire which was mailed to the actual management of the sample companies. Only the reason for change (four possible answers) relating to a specific and precisely determined CEO who had left in the past was
of interest. This constitutes a rather simple and speedy way of determining the reason behind the fluctuation. To eliminate erroneous classifications due to differing interpretations of the abstract turnover-reasons, we decided to simplify and concentrate on real change types: the number of reasons was thus reduced. To compensate for this reduction we introduced an additional class of "other change-reasons". All CEO turnovers selected for this type share the quality that they cannot be classified under one of the three real types of change. Because of the variety of reasons that are represented in this change group, we chose to ignore in our detailed examination those CEO fluctuations that were due to "other reasons".

FIGURE 1: Turnover reasons

In order to evaluate the results on change reasons as obtained in the questionnaire, a review of business journals within the two year period surrounding the specific date of turnover was undertaken. Only 4 % of the turnover cases showed a deviation in reasons between these two sources of information. One company, for example, cited "other reasons" for their CEO change, although the turnover was classified as involuntary by the press: it is
claimed that "the board looses faith in his abilities" and that he "left as a consequence of the increasing criticism both from the employees and the shareholders". A classification following the view of the press seems to fit better, as it can be argued that the category "other reasons", in this particular case, was selected by the company in order to avoid having rather sensitive information exposed to the public.

The detailed analysis of the effects of a change in the top executive position focuses on the involuntary change only. Consequently, a paired analysis was constructed for this subsample only. The control-group companies were selected in a stepwise process, checking first for like industry and then for a two dimensional definition of size (sales, total assets). The company matching best in both industry and size was then selected for the control-group. Except for the fact of turnover in the top executive position, the two groups thus do not differ significantly in either industry or in size.

METHODS AND RESULTS

Differentiating the turnover reasons

A total of 120 companies realized a change in their CEO position during the time under investigation. In relation to other empirical studies (Albach & Freund, 1989) this is a significantly lower occurrence of turnover. This may be a result of the different design of the empirical field used here. We restricted the sample to large corporations only, checking for any turnover at the CEO level as noted in the company report.

Of all companies we questioned regarding the reason for management change, 37 of them (42%) claimed that "retirement, illness or death" of the previous CEO was the reason behind that change. 11 companies reported a voluntary departure, whereas 10 further top executives left their offices for "other reasons". The involuntary change because of "differences over corporate policy" turns out to have occurred in 20 of the companies. A
systematic selection effect cannot be rejected especially with the latter (involuntary change) group. The reason for this turnover might not be easily communicated to the public, as it may be a delicate thing for all persons involved. Another 10 corporations did not provide an outright answer concerning the reason for the turnover - subsequent examination of business journals allowed no clear classification either. This distribution of the reasons for change corresponds to results obtained by Schrader & Lütje (1995), who defined reasons for turnover by reviewing relevant business journals only. It appears that information about turnover reasons gathered via questionnaire is not biased after all - contrary to the assumption that might be made in favor of published information - but has, moreover, the advantage of easy access to the data.

Discussion in previous literature and studies has shown that differentiating among the reasons for change should yield a more accurate explanation of succession effects. We therefore began to compute a simple performance indicator to analyze the development of the earnings during the period of succession, always seeking for the reasons behind these developments. This pre-analysis demonstrated that there is much to be gained from identifying the different turnover reasons and from a subsequent separate analysis of the groups. The different groups of companies undergo differing evolutions in their performance.

If the CEO turnover is based on reasons such as retirement, illness or death, a stable performance development is observable. The company performance glides on at a comparatively high level, experiencing only minimal disturbances over time. It might be reasoned that a successor in office has a strong interest in stability. In the case of mandatory retirement, in particular, it is possible for the company to recruit a potential successor well in advance of the event. Once he has reached the CEO-position he obtains a sound knowledge of the company: disturbances can thus be minimized. In addition, an outgoing CEO in Germany is often rewarded with the presidency of the supervising board. He goes
FIGURE 2
Performance evolution - the individual turnover reasons

ROI

- involuntary turnover
- voluntary turnover
- unavoidable turnover
- other reasons

years

-2
0
2
4
6
8
10
on to execute a considerable amount of power over the new CEO, which may to a certain degree explain the minimal deviations in performance during succession.

If the change may be characterized in terms of a voluntary departure of the CEO, corporate performance takes a different path. Where performance already ranks highly under the outgoing CEO, it tends to improve even further in the following years the under new management. It can be argued that the departing CEO created a sound basis for future improvement – a basis which then benefits his successor. The possibilities for recruitment of a valuable successor should be a point of focus. Positive development in the past and a planned and thereby lubricated transition to a competent executive leads a situation of continued progress. Discussion of results obtained from this group of companies should, however, be undertaken with caution due to the small number of cases.

Companies in which the CEO was forced out of office due to “differences over the business policy” demonstrate the greatest fluctuation in performance over time. Here, a detailed analysis of the effects of the management may be based on the previous discussion of succession phases and reasonably undertaken. We concentrate on performance and financial indicators, these two showing the greatest variance compared to the control cases and over time. In addition to descriptive analysis we also study significance.  

Analysis of performance

For our primary performance analysis we concentrate on the RoI with the investment base defined as total assets. At the beginning of phase 1 in t2, only marginal differences between the change and control groups are observable. In the following year, however (the last one under the influence of the departing CEO), a discrepancy of 5%-points between the two groups is already apparent. Then, although still showing positive profits in t1, the subsequent year under the new management now in office is characterized by a sharp decrease down to -2,1%. While the control-group constantly realizes 5-6% RoI, the last
FIGURE 3
ROI: change group vs. control group

(year's net earnings / total assets) * 100

- - change group
- - control group
FIGURE 4
Source of earnings: change group vs. control group
phase analyzed did see the "change"-companies managing to improve their earnings again in \( t_1 \) and \( t_2 \).

The theoretical assumptions regarding turnover effects appear to be verified by the data presented. With the arrival of the new CEO, RoI undergoes a steep decline - only to improve in the subsequent years as expected.

The following analysis of earnings-components should yield a more detailed explanation of the roots of profitability development.

In contrast to the aggregated RoI, the ordinary operating return already shows a dramatic collapse of 7%-points in the last year of phase 1 (\( t_{1.1} \)). Simultaneous increasing financial return cannot compensate for this decline. Phase 2, with the new management in action, does not demonstrate any further decay in the ordinary operating return. However, the financial return deteriorates significantly from \( t_{1.1} \) to \( t_0 \), weighing in significantly lower than the results obtained in the control-group. A similar trend is seen in the irregular return which undergoes a decline from \( t_{1.1} \) to \( t_0 \), caused mainly by significantly higher extraordinary expenses.

As the new CEO comes into power, the deterioration of ordinary results seen at the end of phase 1 becomes visible in the following phase in terms of overall rentability. This is due to the slackening financial return and to added higher extraordinary expenses. All sources of earning now express the company's situation of shortcoming. The significant increases in extraordinary expenses, in particular, point at possible discretionary action taken by the new top executive. Whether this is due to real effects of the management change or is rather an expression of the behavior commonly known as "taking a bath" in order to improve future prospects cannot be determined in a final way.
The positive trend in corporate performance in latter years following the change does not arise from a substantial improvement in ordinary operating return. This source of income continues, as a matter of fact, to be negative. This is in contrast to the financial return, which heightens with the passing of time since the turnover. This might be a result of a decrease in the indebtedness, which needs to be examined in the financial analysis. Whether the positive group-contribution is a result of successful consolidation or of earnings - often non-payable - that have been mobilized ad hoc cannot be ultimately determined. The extraordinary profit is enhanced in addition, but this is mainly because of the decline in relevant expenses.

Financial analysis

The capital ratio, defined as the contribution of equity capital to the total funds invested, shows a significant deviation over time and in comparison with the control group. If it is generally accepted that companies tend to achieve certain standards of capital ratio, the evolution of this figure in the change-companies would seem to reflect the increasingly critical situation in phases 1 and 2. Although no deviation is detectable in \( t_2 \), change-companies exhibit a significantly lower capital ratio than control-companies. Not even the new management is able to change this situation. Substantial progress in the contribution of equity capital to total funds invested is not achieved by the new CEO.

The development of the "other provisions" ratio, too, is characterized as disruptive during a change in the top executive position. While not showing any deviation in phase 1, a significant increase in this ratio occurs parallel to the new management in charge. The new CEO seems to detect an additional need for provisions against risks. The hypothesis that new management initially tends to view things more pessimistically is supported by this finding. The CEO sets up a greater number of provisions than his predecessor. Although contrary to our expectations, the amount of provision does not go on to slack off in phase 3. This may be either because of a continuing need for internal risk assurance, or may
FIGURE 5
Capital ratio: change group vs. control group

capital ratio

%
FIGURE 6
"Other provisions" ratio: change group vs. control group
indicate an intention to build up undisclosed reserves. Which of these two is true cannot be
decided in a final manner on the basis of the data presented.

Change in accounting principles under new management

Only two companies report changes in accounting principles when drawing up a balance
sheet for the first time under the influence of the new CEO in phase 2. Both cases report
discretionary accounting decisions which have the effect of decreasing income. Unlike the
ratio analysis, which quite clearly reveals the influence exerted by the CEO in his own
favor, an examination of accounting principles does not provide further valid information.
The only conclusion that can be drawn from this finding is that German companies fail to
fulfill the reporting requirements set up by the legislation. This fundamental problem of
insufficient reports, which limits any detailed comparison of different companies, hinders a
deeper analysis in this case, as well.

SUMMARY AND CONCLUSIONS

This analysis examines the influence of CEO changes in large German companies
manifested in their financial statements two years prior to and three years after the
executive turnover. We show that the conflicting results in previous research might have
stemmed from the failure to differentiate among turnover reasons. Companies experiencing
an involuntary change of CEO undergo a different evolution of performance than companies
whose CEOs have changed voluntarily or for reasons like mandatory retirement or death.
Major variance in the financial and performance indicators – heretofore a subject of
controversial discussion in the literature - is especially apparent in situations of involuntary
or forced CEO turnover.

Our detailed analysis of the "involuntary change companies" reveals significant patterns of
influence on the part of the top executive, contingent upon the particular nature of the
change process. Three theoretically deduced phases within the change period can also be observed in the empirical data presented. Certain typical characteristics of the financial situation are evident for each of these phases. Although a cause and effect relationship on the level of single indicators cannot be proven in this research, the overall development-pattern of the financial situation appears to indicate strong CEO influence: In the years prior to the firing, evidence points strongly to an increasingly critical financial situation in the company. The outgoing CEO tends to hide this development, albeit with decreasing success. When the new CEO has taken charge, the data seems to provide further evidence for the phenomenon known as "the financial bath". The incoming CEO sees things from an overly-pessimistic standpoint and uses every possible tool to deteriorate the published company performance. In the latter years of the studied period overall performance then shows improvement, although this is not due to better than ordinary results. Financial analysis reveals no major improvement either.

The total extent of the influence exerted by the top executive can ultimately be determined only on the basis of additional information regarding the accounting decisions made by the CEO. Unfortunately, this type of information is not subject to full disclosure in company reports because of rather extensive loopholes in German accounting regulations. As long as these regulations are not tightened, external analysts should at least - before making a final pronouncement on a company - take into consideration the range of effects found on financial statements in times of CEO change, as discovered in this study.
Some studies have chosen other types of organizations for investigation; for example Smith et al., who analysed ministers of the United Methodist Church, (1984: 767-769).

Basis for this typology is the American organizational constitution, which defines an insider as a pre-succession board-member or member of the management team, and an outsider as an incoming CEO who has not previously been involved in the management of the corporation.

Schrader/Lütje (1993: 3) explicitly point to the fact that organizations normally agree either formally or on an unofficial basis to retire their CEOs at age 65 or 67. For similar empirical evidence see Poensgen/Lukas (1982: 179) and Harrison et al. (1988: 222).

Empirical results indicate this potential danger to a new CEO quite clearly. Fredrickson et al (1988: 258) show that the fluctuation rate of CEOs is significantly higher in their first years in office. See also Chakravarty (1983).

We use a Wilcoxon-test for dependent samples. With $\alpha \leq 0.05$ the difference is referred to as being significant - always bearing in mind that the degree to which one may generalize here is limited by the relatively small sample size.

The significance must be interpreted cautiously, however, because of a great number of ties and since not all companies realize extraordinary expenses. Nonetheless, extraordinary expenses are three times more likely to occur in a period of a change in management than normally, thereby lending additional support to the influence hypothesis.
REFERENCES


Chakravarty, S. N. 1983. Character is destiny. Forbes, Okt. 10.:114-123.


Murphy, K. J., & Zimmermen, J. L. 1993. Financial performance surrounding CEO

Osborn, R. N. et. al. 1981. The event of CEO succession, performance and environmental


Salancik, G. R. et al. 1980. Administrative turnover as a response to unmanaged

Unternehmung: Eine empirische Analyse*. Working paper no. 325. Institute für
Betriebswirtschaftslehre der Universität Kiel.

Unternehmung: Eine empirische Analyse. *Zeitschrift für Betriebswirtschaft*, 65: 467-
492.

Schwartz, K. B., & Menon, K. 1985. Executive Succession in failing firms. *Academy of

Smith, J. E. et al. 1984. Leadership: it can make a difference. *Academy of Management


Weiner, N., & Mahoney, T. A. 1981. A modell of corporate performance as a funktion of
environmental, organizational, and leadership influences. *Academy of Management