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Political connection and managerial entrenchment: evidence from CEO turnovers in China

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Abstract

Firms seek political connection by hiring politicians and ex-bureaucrats as top executives in China, especially in privately controlled firms. One unintended consequence of establishing political connection is management entrenchment. Political connected CEOs have smaller equity holding than CEOs without political background. Political connection significantly lowers the CEO turnover probability and turnover-performance sensitivity. Firm performance improves after political connected CEOs are replaced, particularly if replaced by new ones not politically connected. Overall, our findings suggest that political connection in association with management entrenchment destroys shareholder value, harms firm performance, and exacerbates corporate governance in emerging economies.

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Abstract

This paper provides empirical evidence that political connection can hurt corporate governance by aggravating managerial entrenchment. CEO's political connection lowers the probability of forced CEO turnover by about 20% on average in Chinese listed firms. This pattern is especially strong in privately controlled firms compared to state-owned enterprises. Political connection also significantly lowers the sensitivity between CEO turnover and firm performance, thereby weakening disciplinary mechanism to replace poorly performing CEOs. Following forced CEO turnover in the presence of political connection, firm performance improves. These findings provide strong evidence that political connection does indeed lead to undesirable managerial entrenchment.

Key words: Turnover, political connection, incentives, China, managerial entrenchment

JEL: G30 G32 G34

1. Introduction

A substantial body of literature on political connection has emerged in recent years (Faccio et al., 2006; Fan et al., 2007; Li et al., 2008; Claessens et al., 2008; Chen et al., 2010; Faccio, 2010; Faccio et al., 2010). The extant studies focus primarily on the sources of value that political connection provides, such as preferential access to credit, regulatory protection, and government financial assistance. Whereas these benefits can enhance firm value, research also points to the downside of such connections: the substantial resources that politically connected firms must dedicate to rent seeking activities (Faccio, 2010). In the case of China, although several papers document a positive effect of political connection in privately controlled firms (Li et al., 2006; Li et al., 2008), Fan et al., (2007) provide clear evidence of its negative effect on firm performance in state-owned enterprises (SOEs).

One important disciplinary mechanism for enhancing managerial incentives is CEO turnover, a credible threat or action to replace underperforming CEOs, whose relationship to firm performance has been studied extensively (Denis et al., 1997; Volpin, 2002; Huson et al., 2004; Cheng et al., 2008; Conyon and He, 2008; Chang and Wong, 2009). These prior studies, often treating CEO turnover as an internal monitoring mechanism, document both a negative relationship between CEO turnover and firm performance and an improvement in firm performance after CEO replacement. Our paper thus attempts to fill a research void by examining the impact of political connection on CEO turnover and the turnover-performance relationship.

In China, political connection is a common phenomenon because, even though the corporatization and privatization of state owned economy since 1978 has resulted somewhat in the decentralization of authority, the state shareholder still controls

personnel decisions. Most particularly, either the central or local government has authority over the selection, appointment, and dismissal of top executives in SOEs. Even privately controlled firms, if converted from former SOEs, are likely to build political connections or maintain previous connections because they provide preferential access to financial resources like loans and help companies to avoid strict regulatory oversight (Dinc, 2005; Faccio et al., 2006; Claessens et al., 2008). At the same time, because China is also a transitional economy with weak law enforcement and institutional constraints, many Chinese companies are involved with the state, operate with low efficiency (Wei et al., 2005), and have poor corporate governance (Firth et al., 2006). Thus, whether CEOs are disciplined appropriately and monitored effectively remains an open question. The Chinese context therefore provides an excellent laboratory in which to examine and explain the effects of political connection on the corporate governance system, particularly on CEO turnover and turnover-performance sensitivity.

Based on a comprehensive sample of CEO turnover in China's listed firms from 2002 to 2007, we define politically connected firms as those whose CEOs were formerly or are currently officers affiliated with the government.[1] We find that nearly 45% of the CEOs in our sample are politically connected, 34.55% in SOEs and 10.45% in privately controlled firms. First, we not only find a significant negative relationship between CEO turnover and firm performance, we show that this relationship is much stronger in privately controlled firms than in SOEs, which suggests that such CEO turnover is occurring to replace poorly performing executives. Second, we find that CEOs are less likely to be replaced if they are politically connected, an effect that is significantly stronger in privately controlled firms. Third,

[1] Our definition of political connection is the same as that used in previous studies, including Faccio et al. (2006), Fan et al. (2007) and Chen et al. (2010).

we find that, consistent with Denis et al. (1997), managerial ownership is inversely related to CEO turnover. We also provide strong empirical evidence that CEOs with political connections are associated with a significantly lower turnover-performance relationship than their non-politically connected peers. More important, we find that following CEO turnover, firm performance increases more significantly in firms without political connections than in those with political connections. However, in firms with such connections, CEO replacement can effectively enhance firm performance relative to the performance of firms in which no CEO replacement occurs.

To the best of our knowledge, this is the first study to document the entrenchment effect of CEOs' political connections, which, our results indicate, can substitute for the disciplinary mechanism of CEO turnover by lowering turnover-performance sensitivity. In fact, the evidence clearly suggests that politically connected CEOs are more entrenched and more likely to retain their positions even when the firm is experiencing poor performance. By being among the first to carry out comprehensive analysis of the CEO turnover-firm performance association in China, this study makes a valuable contribution to the extant literature on corporate governance. Most particularly, we offer the first empirical findings on whether political connection affects CEO turnover and how it substitutes for internal governance by lowering turnover-performance sensitivity.

The remainder of this paper is structured as follows. Section 2 provides a brief review of the extant literature. Section 3 develops detailed hypotheses. Section 4 describes the data and outlines the research methods. Section 5 reports the empirical results. Section 6 presents our examination of post-turnover performance, and section 7 concludes the paper.

2. Literature review

International evidence on executive turnover, a major topic within the corporate governance area, amply documents the replacement of top executives as an alternative mechanism for disciplining underperforming top executives by showing that CEO turnover is often associated with poor firm performance and low managerial ownership (Kaplan, 1994a, 1994b; Kang and Shivdasani, 1995; Franks et al., 2001; Conyon and Florou, 2002; Volpin, 2002). Weisbach (1988) finds that poor firm performance is related to forced CEO turnover. Denis et al. (1997), furthermore, provide evidence that CEO turnover is negatively related to the ownership stake of officers and directors. We therefore extend Denis et al. (1997) by explicitly examining whether political connection of CEOs affects CEO turnovers in addition to ownership of executives.

Several studies examine top executive turnover and its relation to firm performance in China (Groves et al., 1995; Aivazian et al., 2005; Fan et al., 2007; Cheng et al., 2008; Chang and Wong, 2009). Among these, Kato and Long (2006) show that CEO turnover is negatively related to a firm's financial performance, a finding that Firth et al. (2006) confirm by focusing on the relationship between chairman turnover and firm performance. Likewise, Conyon and He (2008), who examine both CEO and chairman turnover using a 1999−2006 sample of 1,200 Chinese listed firms, find that, consistent with the agency model, the turnover of both types of top official is inversely related to a firm's profitability.

Studies on the function of political connection provide evidence for two different aspects: the benefits of political connection and the costs of related rent seeking activities. Studies focused on the benefits show that political connection can help

firms by relaxing tax regulation, enabling preferential corporate bailouts and/or financing convenience, and facilitating rent seeking (Faccio et al., 2006; Claessens et al., 2008; Chen et al., 2010), all of which suggest a positive effect on firm value and performance. Other researchers, however, argue that politically connected firms must devote substantial resources to their rent seeking activities, which may well eliminate any advantage from the political connection (Fan et al., 2007; Faccio, 2010). These authors view political connection as government intervention and a desire to satisfy the objectives of social services. Both viewpoints are observable in the emerging research on China. Li et al. (2008), for instance, using a sample of China's privately controlled listed firms, provide evidence that politically connected CEOs have a positive effect on firm performance. Fan et al. (2007), on the other hand, who use a 1993−2001 sample of IPO firms to focus primarily on the intervention of political connection, argue that politically connected firms underperform those without political connection. These previous studies, however, do not examine the effect of political connection on CEO turnover. We therefore hope to shed light on this issue using a sample of all the nonfinancial firms listed on two Chinese stock exchanges.

3. Institutional background and hypotheses

Over the last 30 years, China has adopted economic reforms and an SOE restructuring process that have resulted in decision-making rights being decentralized from the government to the firm level, Nonetheless, although the state has relinquished authority in some areas, it retains control of many SOEs, particularly in terms of appointments to top managerial positions in state-controlled firms. Thus, political intervention has a significant impact on corporate governance systems. Moreover, as many authors argue, it is not the state itself that is the real owner of

SOEs but rather agents of the government who are acting on the government's behalf. As a result, state shareholders have multiple objectives beyond simply maximizing firm value as expected in the traditional agency model. There is therefore a need to examine how top management is monitored and whether the current internal monitoring mechanism is effective.

During the early 1990s, some SOEs were allowed to issue shares and trade on the two stock exchanges set up in Shanghai and Shenzhen. The motivation behind this corporatization and privatization process was the government's desire to adopt a market-oriented economic system. In this sense, CEOs are now acting more like their counterparts in western countries and are taking responsibility for maximizing shareholder wealth. According to agency theory, there is a high probability that these CEOs will be terminated or replaced in the presence of poor firm performance, suggesting a negative relationship between CEO turnover and firm performance that is indeed supported by many studies on China (Kato and Long, 2005; Firth et al., 2006; Chang and Wong, 2009). We therefore construct the following hypothesis:

H1: CEO turnover is negatively related to firm performance.

The emerging research on China also extensively examines the role of political connection (Li et al., 2008; Wu et al., 2008; Chen et al., 2010), pointing to its occurrence in both SOEs and privately controlled firms. Chinese SOEs, however, have one unique characteristic: a politically controlled personnel system in which different levels of government have the ultimate authority over the appointment and dismissal of many top executives, which results directly in politically connected CEOs. In addition, SOE reform has been characterized by the separation of the government function from enterprise management, leading many government officials to choose positions in the latter over their original positions in government.

On the other hand, since the Chinese market appears underdeveloped and inefficient and provides little protection for outside investors, the privately controlled firms have incentives to establish political connections to extract rents from the government and obtain relief from some of their problems (Faccio, 2010). As a result, two waves of political connection establishment took place in privately controlled firms, involving mainly politically connected CEOs. The first wave occurred in the early 1990s just after Deng Xiaoping's inspection of south China, when many government officials chose to become self-employed and establish their own businesses. The second wave transpired during the early 2000s when some government officials relinquished their original positions to accept posts in privately controlled firms. These privately controlled firms, in turn, were likely to appoint politically connected CEOs, especially when they found themselves in financial distress (Li et al., 2006). This political connection in privately controlled firms is seen as a resource and a protection from government that can improve firm performance and overcome state or market failure (Li et al., 2008). Consequently, private investors are more likely to retain politically connected CEOs in order to maintain their power and performance. Accordingly, because of the benefits derived from such political connection, we conjecture that politically connected CEOs are more likely to be entrenched and less likely to be dismissed:

H2: CEO turnover is negatively related to CEO political connection.

As discussed above, politically connected CEOs are less likely to be terminated, suggesting a weaker relationship between CEO turnover and firm performance. In addition, the State-Owned Assets Supervision and Administration Committee of the State Council (SASAC), the agent of the government, has issued interim regulations on evaluating the operating performance of top executives in central government

affiliated SOEs, which include a "talking system" that precludes the punishment or immediate dismissal of poorly performing executives in SASAC-controlled SOEs. In such cases, the SASAC sends experts to help these SOEs overcome performance failure (SASAC, 2003), a mediation also used in SOEs controlled by the local SASAC. Moreover, because these politically connected CEOs are more likely to act as government representatives, they care more about the growth of the state-owned assets invested in SOEs and such objectives as the labor force supply and the region's budgetary deficit (Chang and Wong, 2009). Nonetheless, politically connected CEOs in privately controlled firms also have a close relationship with the government and always perform better than their peers without political connections. At the same time, private investors are motivated to retain all the benefits arising from their political connections and are less likely to dismiss politically connected CEOs even when they underperform. Therefore, political connection is likely to lead to a weaker turnover-performance relationship:

H3: The CEO turnover-firm performance relationship is weaker if the CEO is politically connected.

Because state-owned firms operate with multiple objectives (e.g., providing social services), they do not focus solely on maximizing firm value (Clarke, 2003). In this sense, CEO turnover in state-owned firms may also be determined by certain other indicators. Nonetheless, because private investors appoint CEOs as their representatives with the aim of maximizing shareholder wealth, private controlling shareholders have sufficient incentives to monitor top managers and dismiss them for poor performance (Firth et al., 2006). We thus hypothesize the following:

H4: The CEO turnover-firm performance relationship is weaker in SOEs and stronger in privately controlled firms.

Our last hypothesis relates to managerial ownership by politically connected CEOs, who in many cases are awarded firm equity to better align managerial behavior with the interests of shareholders and promote increased firm value (Hu and Zhou, 2008; Benson and Davidson, 2009). In such cases, if the convenience resulting from political connection is to be fully utilized, politically connected CEOs are more likely to be entrenched and less likely to be removed because of their close relationship with the firm:

H5: The CEO turnover-firm performance relationship is weaker if the politically connected CEOs hold managerial ownership.

4. Sample selection and research methods

4.1 Sample selection

We obtain information on CEO-specific characteristics from the Chinese Stock and Market Accounting Research (CSMAR) database and on firm-specific characteristics from the SinoFin database. Our original sample consists of all firms listed on both the Shanghai and Shenzhen stock exchanges from 2002 to 2007. We begin our sample in 2002 because listed firms have been exercising new accounting and audit standards since 2001. Consistent with prior studies, we delete ST and *ST[2] firms from our population. To address the specially regulated industry consideration, we also exclude financial industry firms with unique accounting standards. Finally, we exclude observations for which information is missing. Our final sample consists of 1,096 listed firms and 6,297 firm-year observations. Table 1 lists the detailed information on CEO turnover and departing CEOs. The total number of turnovers is

[2] ST stands for special treatment. The stock exchanges flag a listed firm ST when irregularities appear in its financial or accounting statement. These firms also have negative net profits for two consecutive years. *ST refers to listed firms that have negative net profits for three consecutive years and have a high probability of being delisted from the stock exchanges.

1,422.

We manually collect the data on CEOs' political connection by searching the listed firm's annual reports from 2002 to 2007. For every firm in each year, we compile a CEO profile that includes age, gender, education, experience, and professional background. Based on this profile, we trace CEOs' political connections by examining whether they are current or former officers of either the central government, the local government, or the military; are members of the standing committee of the National People's Congress (NPC), the Chinese People's Political Consultative Conference (CPPCC), or the All-China Federation of Industry and Commerce (ACFIC); or are the secretary or a member of a party committee in SOEs.

INSERT TABLE 1 HERE

Distinguishing between forced and voluntary turnovers based on public information is difficult because the press is unlikely to explicitly mention whether the CEO turnover was forced or not. Therefore, to examine the effectiveness of monitoring CEO turnover as a punishment related to poor firm performance, we adopt the following procedure to define CEO turnover. First, we obtain the reasons for the CEO turnover from the CSMAR database and, for ease of exposition, partition them into two groups: normal and forced. The normal turnover group includes 745 cases in which the stated reasons are retirement, contract expiration, resignation, completion of active duties, health, personal reasons, change in controlling shareholder, legal disputes, and corporate governance reform. For the remaining turnovers, we trace the destinations of the departing CEOs to identify whether the turnover was normal or forced. Of the remaining 677 cases, 225 cases appear to be normal turnovers, including 10 cases in which the CEO took up a position in the government, 92 cases in which the CEO was promoted to chairman or vice chairman of the board, 51 cases

in which the CEO accepted a managerial position in the parent company, 70 cases in which the CEO remained as chairman or vice-chairman, and 2 cases in which the CEO was going abroad for further education.

We treat the remaining 452 cases as forced turnovers. These include 94 cases in which the CEO took up a less prestigious position within the firm, 22 cases in which the CEO left and took up a position in an unlisted or smaller firm, 42 cases in which the CEO was dismissed, and 294 cases in which the departing CEO's destination is untraceable but CEOs are replaced in unusual circumstances within his tenure. We classify these latter as forced turnover because, given the numerous reasons for CEO departure, information on the turnover is unlikely to be unavailable if the turnover was voluntary. In addition, Firth et al. (2006) argue that resignation may be a face saving device for CEOs who would otherwise be punished or dismissed. We therefore conduct robustness tests by reclassifying resignation as a forced turnover.

Of our original forced turnover sample, we exclude 31 cases in which the CEO tenure is less than one year, because such a short period is unlikely to reflect poor performance. We also add 20 cases for which the stated reason is retirement but the age of the departing CEO is lower than 60. Finally, we identify 981 cases as normal turnovers and 441 cases as forced turnovers, representing 68.99% and 31.01% of the total turnovers, respectively.

4.2 Methodology

We apply the following regression to examine the effects of political connection on CEO turnovers and the turnover-performance relationship:

$$\begin{aligned} Turnover_{it} = {} & \alpha_0 + \alpha_1 Perf_{it-1} + \alpha_2 Perf_{it-1} * Private_{it} + \alpha_3 Political_{it} + \alpha_4 Political_{it} * Private_{it} \\ & + \alpha_5 Political_{it} * Perf_{it-1} + \alpha_6 Mown_{it} + \alpha_7 Mown_{it} * Perf_{it-1} * Private_{it} + \alpha_8 Size_{it} \\ & + \alpha_9 Age_{it} + \alpha_{10} Tenure_{it} + \alpha_{11} Board_{it} + \alpha_{12} Pond_{it} + \alpha_{13} Lev_{it} + \alpha_{14} Duality_{it} \\ & + Industy + Year + \varepsilon_{it} \end{aligned} \quad (1)$$

where *Turnover* is measured by forced turnover (as delineated above), which can reflect the effectiveness of the CEO monitoring mechanism. *Perf* is firm performance, measured as the return on assets (ROA) and return on sales (ROS); *Political* is a dummy variable, coded 1 if the CEO is politically connected and 0 otherwise; *Size* is firm size, defined as the log of firm total assets; and *Age* is the log of CEO age. *Tenure* is the log of years that the CEO has held the CEO position; *Board* is the log of the total number of directors on the board; *Pond* is the proportion of independent directors on the board; *Lev* is the firm leverage level; and *Duality* is a dummy variable coded 1 if the CEO is also the chairman of the board and 0 otherwise. We also control for industry and year fixed effects.

Following Huson et al. (2001) and Chang and Wong (2009), we use the current year's performance if the CEO turnover occurred in the second half of the year and the previous year's performance if the CEO turnover occurred in the first half of the year. By doing so, we can partially address the endogeneity issue.

4.3 Summary statistics

Table 2 reports the summary statistics for the variables used in this study. As Panel A shows, the total turnover rate is 23%. Our regression also employs a set of control variables that show the average tenure of the CEOs to be 3.26 years, which is longer than that reported by Chang and Wong (2009). The mean value of CEO duality indicates that 12% of the total observations are CEOs who also serve as firm chairman. The results in Panel B also show a significant decrease in the annual turnover rate during the sample period, decreasing from 27.42% in 2002 to 20.63% in 2007. These results also indicate that normal turnover accounts for the majority (around 70%) of total turnovers. As outlined above, the reasons for forced turnovers are related to poor

performance and thus reflect the disciplinary power of the internal monitoring mechanism, whereas the reasons for normal turnovers include retirement, health problems, promotion, moving laterally, and accepting other prestigious positions. Since our paper examines the effect of political connection on CEO turnover and the turnover-performance relationship, the rest of the paper focuses only on forced CEO turnover.

INSERT TABLE 2 HERE

5. Empirical results

5.1 Univariate tests

Table 3 shows the turnover rates by quartile of firm performance for the full sample: it also tests for equality between the lowest and highest quartiles. To do so, we divide the firms into four quartiles based on the industry-adjusted ROA (Panel A) and four quartiles based on the industry-adjusted ROS (Panel B). We find that CEO turnover rate increases with decreasing firm performance. First, the results in Panel A show that CEO turnover is significantly higher for firms with poor ROA than for firms with good ROA. Second, Panel B clearly reveals an association between poor ROS and forced CEO turnover. For example, firms with the poorest ROA (bottom quartile) replaced their CEOs in 9.39% of cases, whereas firms with the highest ROA only replaced their CEOs in 4.57% of cases, a 4.82% difference (9.39%-4.57%) (t-value = 5.35(2.35). These results generally support our hypothesis that forced CEO turnover is positively related to poor firm performance.

INSERT TABLE 3 HERE

Table 4 reports the results of our univariate tests of CEO turnover. Here, we divide

the total sample into two groups of firms with and without political connection. Then, to assess whether the CEO turnover rate shows significant differences, we sort the firms based on firm performance and managerial ownership. For example, in Panel A of Table 4, we divide our total sample into two subsamples (politically connected vs. non-politically firms) and sort them by industry-adjusted ROA. For firms with a higher firm performance, the mean (median) of the CEO turnover rate is 4.80% (0%) in politically connected firms, which is significantly lower than the 6.32% (0%) in non-politically connected firms (t-value = -1.92 (-3.62)). To test robustness, we then repeat our comparative analysis with firms sorted by industry-adjusted ROS and obtain similar results.[3] Overall, the evidence suggests that politically connected CEOs are less likely to be replaced, and that in firms with managerial ownership, political connection can further weaken the turnover-performance relationship. These results are generally consistent with our main hypotheses.

INSERT TABLE 4 HERE

Table 5 lists the results of our comparison of CEO turnover and firm and CEO characteristics. Panel A shows the results for politically connected versus non-politically connected firms based on whether the CEOs are politically connected. As column 1 illustrates, firms with politically connected CEOs not only exhibit significantly lower CEO turnover (t-value = -2.06) but also significantly lower firm performance (t-value is -5.84). In Panel B, however, which compares SOEs with privately controlled firms, the differences in CEO turnover are insignificant, indicating no difference in turnover between SOEs and privately controlled firms. Nonetheless, the average performance in SOEs is better than that in privately

[3] Because of their similarity, we do not report the results here, but the data are available from the authors on request.

controlled firms. These results provide evidence that CEOs in SOEs retain their positions for longer and are older than their counterparts in privately controlled firms (t-values = 4.27 and 12.36, respectively). Panel C, which compares firms with forced CEO turnover and normal turnover, suggests that both experience poor performance while forced one have worse ROS. Overall, the evidence in Table 5 mostly supports our hypotheses.

INSERT TABLE 5 HERE

5.2 Multivariate tests

Table 6 reports our regression estimations of the impact of CEO political connection on the turnover-performance relationship for the total sample. The firm performance measure in Panel A is the industry-adjusted ROA; in Panel B, it is the industry-adjusted ROS. Overall, the results given in Table 6 clearly show that a firm's poor prior performance is significantly related to CEO turnover, a finding consistent with the evidence presented in Table 3 and one that supports our Hypothesis 1 that poorly performing CEOs are more likely than other CEOs to be replaced. Likewise, although the results are not robust to all our specifications, CEO political connection is negatively associated with CEO turnover, which supports Hypothesis 2 that CEOs with political connections are generally less likely to be replaced. Here, the interaction term between prior firm performance and political connection remains positive and significant at the 1% level in all specifications, strongly supporting Hypothesis 3 that political connection lowers the turnover-performance sensitivity. This finding offers new evidence that political connection feeds into the entrenchment ability of poorly performing CEOs.

In addition, *Mown*, the proportion of shares held by the CEO, is negatively associated with CEO turnover, but the coefficient is not significant. The interactive

term between *Mown* and political connection, however, is negatively associated with CEO turnover, which suggests that politically connected CEOs, particularly those with more equity ownership, are less likely to be replaced. Similarly, the interaction term between political connection and the private firm dummy has a negative coefficient: political connected CEOs in privately controlled firms are less likely than those in state-owned firms to be replaced. One possible explanation for this observation is that politically connected CEOs bring benefits to privately controlled firms and hence have lower turnover rates.

INSERT TABLE 6 HERE

Some control variables capture the possible influence of firm or CEO characteristics on CEO turnover. Of these, CEO age has a positive effect on turnover, whereas CEO tenure has a negative effect on turnover. As regards corporate governance variables, board size, independent director proportion, and CEO duality have no effect on CEO turnover. Moreover, in contrast to prior studies, we find no relation between CEO turnover and firm size and leverage.

5.3 Tests for robustness

The above analyses using firm performance as the criterion for replacing top management support the hypothesized association between CEO turnover and poor firm performance, which in turn implies that CEOs may focus on short term performance and have the incentive to manipulate cash flows and earnings (Chang and Wong, 2009). However, as our summary statistics show, the average CEO tenure is 3.26 years, suggesting that this use of annual firm performance may not totally reflect a CEO's ability or contribution. Rather, bad firm performance could result

from such industry risks as policy and regulation changes and/or macroeconomic factors. We therefore create two additional firm performance measures, AROA (AROS), the average industry-adjusted ROA (ROS) over CEO tenure, and DROA (DROS), a dummy variable equal to 1 if the firm ROA (ROS) is higher than the median ROA (ROS) and 0 otherwise. We then re-estimate our main regression using these two additional measures in place of annual firm performance. We find broadly similar results to those reported in Table 6. Some may argue that poor prior stock performance is important for CEO forced turnovers, if small investors are able to exert influence on such disciplining mechanisms. We hence run the regression of CEO turnover by including stock annualized returns as independent variable which turn out to be insignificant.

We also recognize that political connection is not completely exogenous; that is, certain firms (e.g., poor performers) may be more likely to hire CEOs with political connections. Therefore, to control for this endogeneity in our multivariate analysis, we carry out a two-stage logit regression in which the first stage controls for the selection of CEOs with political connections and the second stage uses the predicted probability of political connection as the variable of interest. The general results, given in Table 7, are similar to those for our OLS regression except that some variables in the 2SLS regression are less significant. For example, the interaction term between ROA and political connection remains significant and positive, suggesting that political connection reduces the CEO turnover-firm performance relationship.

INSERT TABLE 7 HERE

6. Post-turnover performance

The previous results suggest that CEO turnover is indeed related to poor firm

performance and that replacing the incumbent CEO is expected to improve firm profitability and performance when firms encounter financial distress. Our results also suggest that this relationship differs across firms with and without political connection. We therefore take advantage of our sample to examine the association between political connection and the changes in firm performance surrounding CEO turnover.

6.1 Political connection versus nonpolitical connection

To examine post-turnover performance in politically versus non-politically connected firms (i.e., those with politically versus non-politically connected CEOs), we run univariate tests on the firm performance changes surrounding CEO turnover in each type of firm. Table 8 summarizes the mean and median of both the industry-adjusted ROA and ROS from three years before to three years after CEO turnover (year *t* = the year in which CEO turnover occurs, year *t*-1 = one year prior to CEO turnover, and year *t*+1 = one year after CEO turnover).

As Panel A shows, in politically connected firms, the mean (median) ROA shows a decline from three years before CEO replacement up to year *t* in which the CEO is replaced. After CEO replacement, the mean (median) ROA increases steadily all through the subsequent three years reaching 1.63 (2.41) in year *t*+3. The summary results for ROS show a similar trend: the mean (median) ROS decreases over the three years before the CEO turnover but begins to increase after the CEO turnover, reaching 2.47 (3.83) in year *t*+3. For the non-politically connected firms, reported in Panel B, the mean (median) of both the ROA and the ROS decrease from year *t*-3 to year *t* and then increase to 2.35 (3.02) and 3.63 (4.55), respectively, in year *t*+3. These results provide clear evidence that CEO turnover is indeed associated with poor firm performance and can help improve post-turnover firm performance.

We are also concerned, however, about the difference in firm performance

between politically and non-politically connected firms. We therefore compare firm performance between the *t*-3 group, the *t* group, and the *t*+3 group, as well as the average firm performance before CEO turnover and average firm performance after CEO turnover and firm performance in the *t* groups of the politically and non-politically connected firms. As Panel C shows, politically connected firms show a marginally significant 1.83% (0.71%) drop in the mean (median) ROA (t-value = 1.67 (1.77)). After CEO replacement, the mean (median) ROA increases to 1.63 (2.41), which although higher than that for the *t* group is insignificant (t-value = -1.08 (-1.60)). This comparison of average firm performance thus provides consistent evidence that CEO replacement occurs because of poor firm performance and that average firm performance increases significantly after CEO replacement (t-value = -1.95 (-1.15)). The ROS comparison for politically connected firms provides similar results but the range is larger. The mean (median) ROS decreases by 7.34% (1.76%) from *t*-3 to *t* (t-value = 1.99 (1.88)) and increases by 4.92% (1.42%) from *t* to *t*+3 (t-value = -1.14 (-1.65)).

For non-politically connected firms, the results, given in Panel D, show a significant 1.83% (0.71%) reduction in the mean (median) ROA (t-value = 2.38 (1.78)) but a 2.25% (1.08%) increase in year *t*+3 (t-value is -1.96 (-3.09)). The average firm performance before and after CEO turnover is significantly higher than that for the year *t* group (t-values = 2.16 (2.32) and -1.96 (-1.64), respectively). The ROS comparison shows a broadly similar trend

Overall, this evidence is consistent with both our conjecture and our regression results and reflects both the effectiveness of management monitoring and a weakened turnover-performance relationship in politically connected firms. More important, the results also show that post-turnover performance in non-politically connected firms is

better than that in politically connected firms, which suggests an entrenchment effect of politically connected CEOs.

INSERT TABLE 8 HERE

In addition to the above univariate tests, we also apply the following regression to test the effect of political connection on post-replacement firm performance in the sample of firms in which CEO turnover occurs:

$$\Delta Perf_{it} = \alpha_0 + \alpha_1 Political_{it} + \alpha_2 Size_{it} + \alpha_3 Board_{it} + \alpha_4 Pond_{it} + \alpha_5 Lev_{it} + \alpha_6 Age_{it} + \alpha_7 Tenure_{it} + \varepsilon_{it} \quad (2)$$

where $\Delta Perf$ is the change in firm performance used in the univariate tests. We choose this measurement because it allows assessment of whether firm performance increases following CEO turnover. All other variables are as defined in Equation (1). The estimation results are given in Table 9, which reports the outcomes when the dependent variable is measured as the difference in firm performance between the average of year (t+1, t+3) and year t.[4] In general, the multivariate results suggest that for politically connected listed firms, the post-turnover performance shows a less significant improvement than in non-politically connected firms.

INSERT TABLE 9 HERE

6.2 Turnover versus nonturnover

To enable comparison of post-turnover performance within politically connected firms with and without CEO turnover, we assume a CEO turnover when the length of CEO tenure reaches four years (because the average tenure for CEOs is 3.26 years). We then run univariate tests on the firm performance changes surrounding this

[4] We also apply three other firm performance measures; namely, the difference in firm performance between year t+3 and t and between t-3 and t, and the average of (t-3, t-1) and t. The results for all three variables are consistent with those for the above univariate tests.

assumed turnover.[5] Consistent with the univariate tests reported in Section 6.1, in Table 10, we summarize the mean and median of both the industry-adjusted ROA and the industry-adjusted ROS from three years before to three years after CEO turnover. For politically connected firms without CEO turnover (Panel B), the mean (median) ROA remains positive before turnover but drops to negative after it, and the mean (median) ROS shows a similar trend. In terms of the equality of the firm performance changes during the period surrounding the turnover, the comparison results for the firms with CEO turnover indicate that firm performance increases significantly after CEO replacement (Panel C), while those for the firms without CEO turnover indicate that firm performance across these years does not differ significantly (Panel D).

We also compare the degree of change in firm performance between firms with forced turnover and those without connections whose CEOs are politically connected. As Panel E, Table 10 shows, the difference test indicates that the increase in firm performance for the group of firms with CEO turnover is significantly higher than that for the group of firms without CEO turnover. Together with the evidence from the summary statistics on politically connected firms with CEO turnover, the results indicate that the CEO monitoring mechanism is effective in politically connected firms. More important, the overall evidence suggests an entrenchment effect for politically connected CEOs; that is, politically connected CEOs retain their managerial positions even if they underperform. Once these politically connected CEOs are replaced, however, post-turnover firm performance can improve significantly.

INSERT TABLE 10 HERE

[5] We also tested the robustness of these results using an assumed turnover at three years of tenure..

To provide supportive evidence, we apply the following regression to examine the effect of political connection on post-turnover performance using the sample of politically connected firms:

$$\Delta Perf_{it} = \alpha_0 + \alpha_1 Turnover_{it} + \alpha_2 Size_{it} + \alpha_3 Board_{it} + \alpha_4 Pond_{it} + \alpha_5 Lev_{it} + \alpha_6 Age_{it} + \alpha_7 Tenure_{it} + \varepsilon_{it} \quad (3)$$

where *Turnover* is a dummy variable equal to 1 if the CEO is replaced and 0 otherwise. All other variables are defined as in Equation (2). In general, the regression results, reported in Table 11, indicate that the turnover of politically connected CEOs can produce a more significant improvement in firm performance than occurs in firms where no such turnover takes place.

INSERT TABLE 11 HERE

7. Conclusion

In China, currently the largest transitional economy, political intervention and influence have important implications for both social and economic activity. The political connection of CEOs, particularly, whether in state-owned or privately controlled firms, may be seen as both a means of securing property rights protection and as a major source of rent-seeking behavior. In China, however, the lack of legal protection for investors means that minority shareholders frequently have limited influence over management. Thus, internal monitoring mechanisms, particularly CEO turnover, play an important role in disciplining management. Because such turnover may be linked to political connection, we examine the effect of CEO political connection on corporate governance, focusing particularly on its association with CEO turnover and the turnover-performance relationship. In doing so, we provide the first empirical evidence that CEO political connection not only has a substantial

impact on CEO turnover and the turnover-performance relationship but also a differential effect on SOEs versus privately controlled firms.

Using an extensive 2002−2007 sample of China's listed firms, we find that CEO turnover is associated with poor prior firm performance and that turnover-performance sensitivity is stronger in privately controlled than in state-owned firms. We also provide evidence that political connection has a negative effect on CEO turnover, suggesting it can reduce the likelihood of CEOs' being replaced, and lowers turnover-performance sensitivity, implying a substitution effect on internal disciplinary mechanism that enhances the entrenchment of poor-quality CEOs with political backgrounds. We further find that privately controlled firms are more likely than SOEs to retain politically connected CEOs and that the CEO turnover-firm performance relationship is much weaker if the CEOs hold managerial ownership. Following the forced turnover of CEOs, however, firm performance improves, especially in firms whose CEOs have no political connections. Overall, our findings suggest that in an emerging economy, political connections have a significant influence on corporate governance; most particularly, an adverse effect on internal monitoring mechanisms that results in undesirable management entrenchment.

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Table 1. Reasons for CEO turnover

This table reports the reasons for and frequencies of CEO turnover in China's listed firms between 2002 and 2007.

Reasons for turnover	Number of observations	Percentage of sample
1. Normal turnover	981 [a]	68.99%
Retirement	22	1.55%
Contract expiration	298	20.96%
Change in controlling shareholder	12	0.84%
Resignation	300	21.10%
Health	37	2.60%
Personal reasons	36	2.53%
Corporate governance reform	25	1.76%
Legal dispute	1	0.07%
Completion of active duties	14	0.98%
Important government position taken up	10	0.70%
Promoted to chairman or vice-chairman	92	6.47%
CEO position taken up at parent company	51	3.59%
Remaining as chairman or vice-chairman	70	4.92%
Going abroad to study	2	0.14%
2. Forced turnover	441 [b]	31.01%
New position ranked lower than CEO position	94	6.61%
CEO position taken up at an unlisted, smaller firm	22	1.55%
Dismissed	42	2.95%
Details not provided	294	20.68%
Total number of observations	1422	100%

[a] We delete 20 cases in which the stated reason is retirement but the age of the departing CEO is lower than 60. We also add 31 cases in which the tenure of the departing CEO is less than 1 year. Eventually, we obtain 981 normal turnovers.

[b] We add 20 cases in which the stated reason is retirement but the age of the departing CEO is lower than 60. We also delete 31 cases in which the tenure of the departing CEO is less than 1 year. Eventually, we obtain 441 forced turnovers.

Table 2. Summary statistics

Variables	Mean	Median	Lower 25% quartile	Higher 25% quartile
Panel A: Summary statistics for the full sample				
Turnover	0.23	0	0	1
ROA (%)	2.25	2.64	0.84	5.12
ROS (%)	4.05	4.43	1.49	9.80
Firm size (million)	3,940	1,770	1,010	3,390
Lev (%)	49.71	50.25	36.92	62.10
CEO tenure	3.26	3	1.92	4.33
CEO age	46.47	46	41	51
CEO duality	0.12	0	0	0
Board	9.76	9	9	11
Independent directors	3.13	3	3	4

Panel B: Turnover rate across years						
Year	2002	2003	2004	2005	2006	2007
Total turnovers	269	242	231	255	216	209
Percentage [a]	27.42%	23.96%	21.08%	22.87%	20.96%	20.63%
Normal turnovers	198	160	155	176	142	152
Percentage [b]	73.61%	66.12%	67.10%	69.02%	65.74%	72.73%
Forced turnovers	71	82	76	79	74	57
Percentage [b]	26.39%	33.88%	32.90%	30.98%	34.26%	27.27%

[a] The percentage of total turnover is the ratio of the number of turnovers to the total firm year observations for a specific year.

[b] The percentage of normal and forced turnover is the ratio of normal and forced turnovers to the number of total turnovers.

Table 3. Forced turnover rate according to firm performance quartile

	Firm performance	CEO turnover
Penal A: Summary statistics based on ROA (%)		
Bottom quartile	-7.97(-2.56)	0.0939
Second quartile	-0.91(-0.91)	0.0747
Third quartile	1.17(1.15)	0.0658
Top quartile	6.21(4.95)	0.0457
Difference (t-test) [a]		5.35***(2.35**)
Penal B: Summary statistics based on ROS (%)		
Bottom quartile	-35.86(-5.99)	0.0959
Second quartile	-1.49(-1.52)	0.0699
Third quartile	2.09(1.86)	0.0636
Top quartile	20.27(10.79)	0.0507
Difference (t-test) [a]		4.89***(2.20**)

[a] The above table displays the results of the difference tests between the bottom and top quartiles and reports the t-values (p-values).

The value in the firm performance column is the mean (median) within the quartiles.

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 4. Univariate test of CEO turnover based on performance and ownership

	Politically connected	Non-politically connected	t-test
Panel A: Firms sorted by firm performance (ROA)			
Upper	4.80(0)	6.32(0)	-1.92*(-3.62**)
Lower	7.83(0)	8.97(0)	-1.36(-1.87*)
t-test	-3.44**(-2.09**)	-2.85**(-1.72*)	
Panel B: Privately controlled firms sorted by firm performance (ROA)			
Upper	0.95(0)	7.52(0)	-5.43**(-2.64**)
Lower	7.96(0)	10.12(0)	-2.06**(1.05)
t-test	-4.31**(-2.31**)	-2.45**(-2.51**)	
Panel C: Firms sorted by CEO's equity ownership			
Upper	2.61(0)	2.79(0)	-2.23**(-0.05)
Lower	7.74(0)	9.69(0)	-2.32**(-5.33**)
t-test	-6.47**(-4.79**)	-8.46**(-9.67**)	

The mean (median) value is CEO turnover rate (%), and "Upper" and "Lower" refer to firms whose performance is above or below the median value.

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 5. Comparison of firm and CEO characteristics

	Turnover	ROA	ROS	Leverage	Firm size	Board	Pond	CEO tenure	CEO age	Obs
Panel A: Firms sorted by CEO political connection										
Political	6.32	-1.03	-3.91	50.21	21.36	2.27	0.32	3.15	46.93	3039
	(0)	(-0.16)	(-0.13)	(50.17)	(21.26)	(2.19)	(0.33)	(2.67)	(47.00)	
Non-political	7.64	0.24	-3.59	49.24	21.41	2.24	0.33	2.90	44.45	3258
	(0)	(0.13)	(0.12)	(50.37)	(21.32)	(2.19)	(0.33)	(2.58)	(43.00)	
t-test	-2.06	-5.84	-0.12	1.49	-1.90	4.31	-4.49	5.69	14.95	
Wilcoxon test	(0.91)	(3.69)	(1.86)	(0.61)	(1.82)	(4.05)	(5.39)	(3.24)	(14.62)	
Panel B: Firms sorted by firm type										
SOEs	6.95	-0.04	-1.21	48.57	21.49	2.27	0.32	3.08	46.28	4659
	(0)	(0.04)	(-0.09)	(49.40)	(21.41)	(2.19)	(0.33)	(2.67)	(46.00)	
Private	7.14	-1.35	-10.98	52.95	21.07	2.19	0.34	2.87	43.86	1638
	(0)	(-0.10)	(0.27)	(52.36)	(21.01)	(2.19)	(0.33)	(2.5)	(43.00)	
t-test	-0.26	4.26	1.67	-4.25	17.02	13.48	-10.80	4.27	12.36	
Wilcoxon test	(0.12)	(2.09)	(1.02)	(4.93)	(14.68)	(12.48)	(8.08)	(3.11)	(12.80)	
Panel C: Firms sorted by turnover type [a]										
Forced	N/A	-2.41	-21.98	53.05	21.33	2.25	0.32	3.14	43.76	441
		(-0.79)	(-1.05)	(52.11)	(21.25)	(2.19)	(0.33)	(2.2)	(43.01)	
Normal	N/A	-2.45	-14.48	51.51	21.22	2.24	0.32	2.83	43.67	981
		(-0.74)	(-1.01)	(51.55)	(21.16)	(2.19)	(0.33)	(2.00)	(43.00)	
t-test		0.07	-0.66	0.60	1.81	1.19	-0.65	2.94	0.27	
Wilcoxon test		(0.78)	(1.03)	(0.33)	(1.52)	(0.21)	(0.15)	(3.05)	(0.45)	

[a] This comparative sample excludes the firm year observations without CEO turnover.

The table reports the mean (median) values.

Table 6. Logit regression results for the total sample

Dependent variable: Probability of forced CEO turnover				
Panel A: Regression results when firm performance is measured by industry-adjusted ROA				
Constant	-7.14***(-3.86)	-7.53***(-4.04)	-6.94***(-3.60)	-6.92***(-3.62)
ROA_{t-1}	-1.41**(-2.38)	-5.00***(-4.40)	-4.89***(-4.29)	-4.86***(-4.27)
Political	-0.33***(-2.71)	-0.25**(-2.07)	-0.16(-1.19)	-0.09(-0.69)
ROA_{t-1}*Political		4.55***(3.75)	4.29***(3.50)	4.37***(3.55)
Mown	-0.14(-1.55)	-0.12(-1.43)	-0.12(-1.41)	-0.10(-1.39)
Mown*Political				-5.26*(-1.65)
Private			-0.01(-0.01)	-0.06(-0.04)
Private*Political			-0.57*(-1.73)	-0.58*(-1.74)
Size	0.04(0.58)	0.06(0.90)	0.05(0.70)	0.04(0.61)
Age	0.84**(2.12)	0.82**(2.09)	0.77*(1.93)	0.79**(2.02)
Tenure	-1.43***(-26.62)	-1.42***(-26.70)	-1.43***(-27.09)	-1.42***(-26.71)
Board	0.19(0.69)	0.18(0.63)	0.12(0.45)	0.12(0.42)
Pond	1.04(1.33)	0.95(1.23)	0.98(1.27)	0.99(1.27)
Lev	-0.06(-0.04)	-0.09(-0.39)	-0.06(-0.22)	-0.04(-0.17)
Duality	-0.36*(-1.64)	-0.33(-1.55)	-0.28(-1.36)	-0.27(-1.27)
Year	Included	Included	Included	Included
Industry	Included	Included	Included	Included
Pseudo R^2	0.2695	0.2739	0.2759	0.2785
Obs	6297	6297	6297	6297
Panel B: Regression results when firm performance is measured by industry- adjusted ROS				
Constant	-6.69***(-3.62)	-6.67***(-3.60)	-5.97***(-3.13)	-5.99***(-3.16)
ROS_{t-1}	-0.08**(-2.40)	-0.19**(-2.20)	-0.19**(-2.19)	-0.18**(-2.19)
Political	-0.32**(-2.57)	-0.29**(-2.34)	-0.18(-1.42)	-0.12(-0.92)
ROS_{t-1}*Political		0.23**(2.49)	0.22**(2.48)	0.22**(2.50)
Mown	-0.15(-1.59)	-0.14(-1.58)	-0.14(-1.55)	-0.12(-1.55)
Mown*Political				-5.31*(-1.67)
Private			-0.03(-0.16)	-0.03(-0.18)
Private*Political			-0.57*(-1.72)	-0.58*(-1.75)
Size	0.02(0.28)	0.02(0.19)	-0.02(-0.04)	-0.02(-0.10)
Age	0.82**(2.06)	0.82**(2.06)	0.75*(1.87)	0.78**(1.96)
Tenure	-1.43***(-26.55)	-1.43***(-26.48)	-1.43***(-26.90)	-1.43***(-26.53)
Board	0.19(0.67)	0.21(0.72)	0.15(0.51)	0.14(0.49)
Pond	0.96(1.22)	0.98(1.25)	1.02(1.29)	1.02(1.31)
Lev	0.16(1.53)	0.24**(2.00)	0.28**(2.13)	0.28**(2.12)

Duality	-0.34(-1.59)	-0.36*(-1.65)	-0.31(-1.43)	-0.29(-1.35)
Year	Included	Included	Included	Included
Industry	Included	Included	Included	Included
Pseudo R^2	0.2686	0.2708	0.2729	0.2755
Obs	6297	6297	6297	6297

The dependent variable is the probability of forced CEO turnover. Firm performance is measured by both return on assets (ROA) and return on sales (ROS), defined as the ratio of net income before tax to firm total assets and of net income before tax to firm total sales, respectively. The regressions employ both the industry-adjusted ROA and the industry-adjusted ROS. *Political* is a dummy variable equal to 1 if the CEO is politically connected and 0 otherwise; *Mown* is the CEO's control right, defined as the proportion of shares held by the CEO.; and *Private* is a dummy variable equal to 1 if the firm has a private controlling shareholder and 0 otherwise. *Size* is the log of firm total assets; *Age* is the log of CEO age; and *Tenure* is the log of years that the CEO has held this position. *Board* is the log of total directors on the board and *Pond* is the proportion of independent directors on the board. *Lev* is the firm leverage level, and *Duality* is a dummy variable equal to 1 if the CEO is also the chairman of the board and 0 otherwise.

The t-statistics, computed using the White (1980) heteroscedasticity robust standard error, are in parentheses. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 7. Two-stage logit regression.

First stage: Dependent variable = CEO political connection		
Constant	-7.92***(-5.26)	-6.87***(-4.63)
ROA	-2.19***(-4.82)	
ROS		-0.07(-0.29)
Tenure	0.03(0.88)	0.02(0.42)
Age	2.46***(7.57)	2.40***(7.42)
Size	-0.10**(-2.07)	-0.15***(-2.85)
Board	0.49**(2.28)	0.48**(2.23)
Pond	-1.22**(-2.46)	-1.26**(-2.55)
Duality	0.31**(2.08)	0.32**(2.20)
Year	Included	Included
Industry	Included	Included
Pseudo R^2	0.0332	0.0284
Obs	6297	6297
Second stage: Dependent variable = CEO turnover		
Constant	-12.52(-0.76)	-11.82(-0.51)
ROA_{t-1}	-11.70(-1.43)	-0.15(-1.00)
Political connection	-4.50(-0.38)	-5.83(-0.29)
Mown	-0.05**(-2.00)	-0.03**(-2.37)
ROA_{t-1}*Political connection	12.46**(2.46)	0.42*(1.70)
Private	-0.86(-1.46)	-0.68(-1.10)
Private*Political connection	1.58(1.31)	1.15(0.91)
Mown*Political connection	-0.17**(-1.98)	-0.08**(-2.42)
Size	-0.07(-0.23)	-0.19(-0.28)
Age	3.23(0.46)	3.84(0.33)
Tenure	-1.38***(-12.81)	-1.41***(-15.58)
Board	0.62(0.44)	0.75(0.33)
Pond	-0.14(-0.04)	-0.59(-0.10)
Lev	0.13(0.76)	0.21*(1.91)
Duality	-0.05(-0.06)	-0.06(-0.04)
Year	Included	Included
Industry	Included	Included
Pseudo R^2	0.2731	0.2688
Obs	6297	6297

Here, firm performance is measured by both return on assets (ROA) and return on sales (ROS), and the regressions apply both the industry-adjusted ROA and the industry-adjusted ROS. All other variables are defined as in Table 7.

The t-statistics, computed using the White (1980) heteroscedasticity robust standard error, are in parentheses. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 8. Firm performance surrounding CEO turnover

	Year *t*-3	Year *t*-2	Year *t*-1	Year t	Year *t*+1	Year *t*+2	Year *t*+3
Panel A: Summary statistics for firm performance in politically connected firms [a]							
ROA	2.22(2.30)	2.73(2.31)	2.04(1.83)	0.39(1.59)	0.89(1.49)	1.48(1.76)	1.63(2.41)
ROS	4.99(4.17)	6.49(4.28)	1.46(3.07)	-2.35(2.41)	-0.45(2.49)	2.73(3.18)	2.47(3.83)
Observations	85	111	151	192	141	100	83
Panel B: Summary statistics for firm performance in non-politically connected firms [b]							
ROA	2.66(2.67)	2.43(2.55)	1.30(1.94)	0.10(1.94)	1.96(2.66)	2.68(2.51)	2.35(3.02)
ROS	5.69(5.75)	1.89(4.67)	0.09(3.23)	-28.71(3.77)	-4.24(3.90)	2.77(4.47)	3.63(4.55)
Observations	96	134	183	249	196	153	112
Panel C: Difference tests for firm performance surrounding politically connected CEO turnover							
Different tests	(t-3 and t)		(average of (t-3, t-1) and t)		(t and average of (t+1, t+3))		(t and t+3)
t-tests of ROA	1.67*(1.77*)		2.86***(2.94***)		-1.95*(-1.15)		-1.08(-1.60)
t-tests of ROS	1.99**(1.88*)		2.12**(1.89*)		-1.98**(-1.03)		-1.14(-1.65*)
Panel D: Difference tests for firm performance surrounding non-politically connected CEO turnover							
Different tests	(*t*-3 and *t*)		(average of (*t*-3, *t*-1) and t)		(*t* and average of (*t*+1, *t*+3))		(*t* and *t*+3)
t-tests of ROA	2.38**(1.78*)		2.16**(2.32**)		-1.96**(-1.64*)		-1.96**(-3.09***)
t-tests of ROS	2.15**(2.79***)		1.71*(1.88*)		-1.81*(-1.70*)		-2.16**(-2.12**)

[a] This group of firms replaced politically connected CEOs.

[b] This group of firms replaced non-politically connected CEOs.

Note: the value used for the comparisons are the industry-adjusted ROA and the industry-adjusted ROS. The table reports the mean (median) values.

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 9. CEO political connection effect on post-turnover performance for firms with CEO turnover

Dependent variable	ΔROA	ΔROS
Political	-0.02*(-1.76)	-0.02**(2.57)
Size	0.02**(2.53)	0.04**(2.20)
Board	-0.03(-1.15)	-0.13*(-1.64)
Pond	0.01(0.12)	0.03(0.15)
Lev	-0.08**(-2.31)	-0.36***(-3.59)
Age	0.05(1.16)	0.12(1.09)
Tenure	-0.01(-0.12)	0.01(0.83)
Industry	Included	Included
Year	Included	Included
Observations	459	459
Adjusted R^2	0.04	0.05

Here, the dependent variable is the difference in firm performance between the averages for years (*t*+1, *t*+3) and *t*. All other variables are defined as in previous tables. We report only the results for the primary variables.

The t-statistics, computed using the White (1980) heteroscedasticity robust standard error, are in parentheses. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 10. Comparison of firm performance surrounding CEO turnover in politically connected firms

	Year *t*-3	Year *t*-2	Year *t*-1	Year *t*	Year *t*+1	Year *t*+2	Year *t*+3
Panel A: Summary statistics for firm performance in politically connected firms: with CEO turnover							
ROA	2.22(2.30)	2.73(2.31)	2.04(1.83)	0.39(1.59)	0.89(1.49)	1.48(1.76)	1.63(2.41)
ROS	4.99(4.17)	6.49(4.28)	1.46(3.07)	-2.35(2.41)	-0.45(2.49)	2.73(3.18)	2.47(3.83)
Observations	85	111	151	192	141	100	83
Panel B: Summary statistics for firm performance in politically connected firms: no CEO turnover [a]							
ROA	0.33(0.16)	0.61(0.19)	0.53(0.05)	0.10(0.16)	0.53(0.03)	-0.84(1.07)	-1.43(0.55)
ROS	1.25(0.69)	2.45(0.15)	1.62(0.28)	0.13(0.28)	0.75(-0.09)	-0.40(1.28)	-0.55(-0.16)
Observations	180	205	236	306	220	156	57
Panel C: Difference tests of firm performance CHANGE surrounding politically connected CEO turnover							
Different tests	(*t*-3 and *t*)		(average of (*t*-3, *t*-1) and t)		(*t* and average of (*t*+1, *t*+3))		(*t* and *t*+3)
t-tests of ROA	1.67*(1.77*)		2.86***(2.94***)		-1.95*(-1.15)		-1.08(-1.60)
t-tests of ROS	1.99**(1.88*)		2.12**(1.89*)		-1.98**(-1.03)		-1.14(-1.65*)
Panel D: Difference tests of firm performance CHANGE surrounding politically connected CEO turnover in firms without turnover [a]							
Different tests	(*t*-3 and *t*)		(average of (*t*-3, *t*-1) and *t*)		(*t* and average of (*t*+1, *t*+3))		(*t* and *t*+3)
t-tests of ROA	-0.42(-0.28)		-0.85(0.36)		0.81(-0.49)		-1.34(0.05)
t-tests of ROS	-0.55(-0.98)		-0.76(-0.15)		0.32(-0.86)		-2.27**(-0.73)
Panel E: Difference tests of firm performance CHANGE across these two groups (turnover vs. no turnover)							
Different tests	(*t*-3 and *t*)		(average of (*t*-3, *t*-1) and *t*)		(*t* and average of (*t*+1, *t*+3))		(*t* and *t*+3)
t-tests of ROA	-1.14(-0.19)		-2.64***(-2.43**)		2.07**(1.70*)		1.21(2.19**)
t-tests of ROS	-1.70*(-0.13)		-1.64*(-1.83*)		1.66*(1.68*)		1.72*(2.97***)

[a] The comparison results in Panels C, D, and E are based on an assumed CEO turnover at four years of tenure (because CEO tenure averages 3.26 years).

Table 11. CEO turnover effect on subsequent firm performance for politically connected firms

Dependent variable	ΔROA	ΔROS
Turnover	0.06**(2.46)	0.02**(2.04)
Size	0.03***(6.25)	0.03(0.29)
Board	-0.02(-0.14)	-0.04(-0.13)
Pond	0.04(0.93)	0.70(0.76)
Lev	-0.15***(-7.00)	-0.63(-1.45)
Age	0.02(0.73)	-0.03(-0.06)
Tenure	0.05(1.28)	-0.02(-0.31)
Year and Industry	Included	Included
Observations	1461	1461
Adjusted R^2	0.05	0.03

Here, the dependent variable is the difference in firm performance between the averages for years (*t*+1, *t*+3) and *t*. All other variables are as defined in previous tables. We report only the results for the primary variables.

The t-statistics, computed using the White (1980) heteroscedasticity robust standard error, are in parentheses. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.