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Board chairperson turnover and financial performance: evidence from Chinese firms

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Abstract

This study provides the first empirical evidence on the relationship between the chairman of the board of directors (COB) and corporate financial performance. Using a sample of Chinese A listed firms between 2008-2017, we find reliable evidence that the COB turnover improves corporate financial performance. Moreover, the existence of a majority shareholder (Majority) positively influences corporate financial performance, while firm nature (private majority shareholder or public majority shareholder)(Private) may not.

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1. Introduction

The yearly number of board chairperson (chair of the board [COB]) turnovers from 2008 to 2017 has approximately doubled among Chinese listed firms, reaching 564 turnovers in 2017. In the United States, the chief executive officer (CEO) tends to be the key executive, and the COB can be an independent director (Sun 2018). China has implemented some Western corporate governance principles following the 1993 enactment of the Company Law. However, it still has some unique characteristics, including a high degree of ownership concentration (usually by the State or local/regional government) (Farag and Mallin 2016, Liao et al. 2018) and the existence of a dual board structure (a supervisory committee and a board of directors), with the supervisory board having no significant role in corporate governance (Farag and Mallin 2019). Moreover, previous studies (Li and Liang 2015) and (Zhang et al. 2016) have highlighted that the COB holds the most powerful executive position in Chinese listed firms.

Previous literature has studied the relationship between CEO turnover and financial performance for both Western (Murphy and Zimmerman 1993, Visintin et al. 2017) and Chinese listed firms (Kato and Long 2006, Conyon and He 2014). Furthermore, several scholars have investigated the impact of duality (Chair and CEO dual position) on the performance of firms in China (Mubeen et al. 2021; Mutlu et al. 2018). However, academic research on the relationship between the sole turnover of the COB and financial performance is still scarce.

This study aims to fill this gap and examine the effects of COB turnover on the financial performance of Chinese listed firms from 2008 to 2017. To define the pre- and post-turnover periods, we follow the study by Berger et al. (2014). We clean our data and exclude COB turnovers occurring within a 3-year turnover of a COB or CEO[1]. Pre- and post-turnover periods mean that only one COB turnover should happen in a 7-year window. Subsequently, we use the difference-in-difference (DID) estimators following these settings: (1) without matching methods, (2) with propensity-score-matching (PSM), and (3) with coarsened exact matching (CEM) on the data. Overall, our empirical results report that COB turnovers positively affect the financial performance of Chinese listed firms. Moreover, when there is a COB turnover, our results provide additional information on the impact of the largest owner (*Majority*) and firm nature (*Private*) on financial performance. We conclude that *Majority* positively influences the financial performance of the listed firms, whereas *Private* does not.

Our contribution to the existing literature is twofold. First, we empirically provide evidence of the positive impact of COB turnover on the financial performance of Chinese firms. In addition, we discuss the theoretical contributions of our results to the broader literature on the turnover of a COB and performance of firms. Second, following a methodological perspective, this study is the first to combine DID with PSM and CEM to examine the impact of COB turnover on the financial performance of Chinese listed firms.

The remainder of the paper is organized as follows. Section 2 reviews the literature and presents our research hypothesis. Section 3 discusses the data and research methodology. Section 4 reports the main results, and Section 5 concludes the study.

2. Literature Review

There are two ways to theoretically define the role of the COB. Based on the stewardship theory (Davis et al. 1997), the COB mainly facilitates the executive decision making effectively through collaboration and trust with the executives. Based on the perspective of the agency theory, the COB mitigates the potential opportunistic behavior of executives via supervision and discipline (Eisenhardt 1989). Following this theoretical context, the COB turnover signals

[1] Note : Berger, Kick et al. (2014) remove observations which turnover occur within three years of another turnover. In addition, the average year of the board chair turnover is around 3 in Chinese listed firms.

a change in the leadership of the board of directors and, thus, how the board balances its monitoring (Li and Aida 2018) versus collaborating tasks (Sundaramurthy and Lewis 2003). At the individual level, the COB turnover signals a different working relationship with the CEO (Krause 2017) and mentoring style (Lorsch and Zelleke 2005), which affects the performance of firms.

Although these two theoretical lenses apply to the Chinese context, the country has two additional specificities, providing more power to the COB. First, the Company Law in China stipulates that the COB is the company's legal representative[2] and is accountable for major decisions (Jiang and Kim 2015). The COB, being the chairperson of the strategic committee, can stir not only the strategic decisions of the firm but also the financial performance of firms.

A second noteworthy characteristic of Chinese listed companies is that the COB is often either the principal shareholder or their representative (Li and Liang, 2015). For instance, Li and Liang (2015) demonstrated that in China, more than two third of COBs were the principal shareholders. Moreover, Johnson et al. (2000) found that a controlling shareholder could damage the financial performance of firms by transferring corporate resources away from the firm for their benefit. In addition, the main shareholder in China is often the State or local government, and the COB acts as its representative and can manipulate the actual financial performance (Liu and Lu 2007) to comply with the main objectives of the shareholder and prevent their replacement during a meeting. Alternatively, when a new COB is selected, he/she can show an incentive to report higher financial performances than his/her predecessors to convince the shareholders of his/her ability. Following the aforementioned discussion, we propose that the COB turnover will affect the financial performance of Chinese listed firms.

3. Data and Methodology

We constructed our sample by selecting A-share listed firms from the Shanghai and Shenzhen Stock Exchange between 2008 and 2017. Following the previous literature, we excluded financial institutions because they have specific governance and performance requirements that are not applicable to other companies (Yang et al. 2019). Furthermore, we eliminated firm-year observations comprising missing values. In addition, data were excluded when COB turnovers occurred within three years of another turnover, both before and after, to avoid complications arising from multiple consecutive turnovers (Berger et al. 2014). We further removed observations with the CEO turnover when the COB turnover happened to isolate COB turnovers. Therefore, the dataset includes either no other executive's turnover or exclusively chairperson turnover within a 7-year window. Subsequently, we the divided the dataset between treatment and control groups. The treatment group comprised firms that reported only one turnover within a 7-year event window. The control group comprised firms without a turnover in the aforementioned event window. Before any matching strategy, our sample comprised 9373 firm-year observations, including the treatment and control groups. The main reasons for the turnover of COB from 2011 to 2014 and their respective weight are presented in Table 1. We notice that the first three categories of the causes for COB's turnovers are planned, "transfer," "retirement," and "expiration of the term of office," and thus, the differences regarding financial performance between similar firms are expected to be more endogenous reflecting the actions taken by the new chairperson.

[2] See: http://www.mofcom.gov.cn/article/b/bf/200207/20020700031341.shtml, Chapter Forty-five, said, "The COB is the legal representative of the company." (In Chinese)

Table 1 Board chairperson turnover by year and cause

Year	2011	2012	2013	2014	%
Transfer	10	3	8	9	21.74
Retirement	6	3	6	3	13.04
Expiration of the term of office	16	12	27	17	52.17
Change in controlling rights	1				0.72
Resignation		3	2	2	5.07
Health	1			3	2.90
Personal issue	1				0.72
Corporate governance	1			1	1.45
Other			1	2	2.17
Total	36	21	44	37	100

Source: China Stock Market & Accounting Research (CSMAR) database.

Before any matching method (PSM or CEM), we test the sample using the DID approach as follows:

$$Performance = \alpha_0 + \beta_1 Turnover + \beta_2 Post + \beta_3 Turnover \times Post + \sum_{i=1}^{k} \gamma_k Controls + Year\ Fixed\ Effects + Industry\ Fixed\ Effects + \varepsilon \quad (1)$$

where $Performance$ denotes an accounting ratio, namely, return on asset (ROA) and return on equity (ROE). $Turnover$ is a dummy variable equal to one (zero) for firms in the treatment (control) group. $Post$ is a dummy variable equal to one (zero) for years after (before) a chairperson turnover. In particular, we focused on β_3, the parameter for the cross-term $Turnover \times Post$, which measures the impact on corporate financial performance following the board chair turnover. Following the study by Berger et al. (2014), we examined the variables that could be associated with the outcomes. We controlled for the characteristics of the board of directors, such as board size, board independence, CEO duality, gender, the busyness of directors, governmental background, financial background, and average age. Furthermore, we considered the characteristics of the firm, such as if a majority shareholder was holding more than 50% of the company, the nature of the firm (main shareholder being private or the government), asset size, level of leverage, the ratio of tangible assets, and firm age. Following Hope and Wang (2018), we included the year and industry fixed effects and clustered the standard errors by firms.

Table 2 reports the mean and standard deviation of the variables used in our analysis before any matching techniques. Over the period, our sample included 146 chairperson turnovers.

Table 2 Summary statistics for examined samples

	Treatment group (1)		Control group (2)		All (3)	
	Mean	SD	Mean	SD	Mean	SD
ROA	0.023	0.06	0.047	0.07	0.046	0.07
ROE	0.050	0.12	0.084	0.09	0.084	0.09
Bsize	9.889	2.63	9.858	2.51	9.858	2.51
Duality	0.175	0.38	0.351	0.48	0.348	0.48
Bindep	0.364	0.07	0.389	0.07	0.388	0.07
Femdir	0.085	0.08	0.135	0.12	0.134	0.12
Busydir	0.085	0.11	0.152	0.17	0.151	0.17
Govdir	0.180	0.13	0.150	0.13	0.150	0.13
Findir	0.204	0.25	0.130	0.15	0.131	0.15
Bage	51.096	3.72	50.918	3.71	50.921	3.71
Majority	0.064	0.25	0.141	0.35	0.139	0.35
Private	0.491	0.50	0.697	0.46	0.693	0.46
Log (Asset)	21.560	1.02	22.075	1.35	22.066	1.35
Leverage	0.502	0.22	0.452	0.31	0.453	0.31
Tangible ratio	0.244	0.22	0.224	0.17	0.224	0.17
Fage	12.550	5.86	10.407	6.22	10.446	6.22

Source: CSMAR database.

Note: The table presents the summary statistics of our sample before any matching strategy. Column (1) refers to the sample of firms that experienced one chairperson turnover. One hundred forty-six chairperson turnovers occur during the period. Column (2) refers to the sample of firms that experienced nonchairperson turnover over a 7-year window. Column (3) presents the mean and standard deviation values of the whole sample. Variables include the two financial performance measurements; *ROA* (return on assets) and *ROE* (return on equity); *Bsize* (the number of directors on the board); *Duality* (CEO duality); *Bindep* (the proportion of independent directors); *Femdir* (the ratio of women directors); *Busydir* (the proportion of business directors); *Govdir* (the proportion of directors with political background); *Findir* (the proportion of directors with a financial background), *Bage* (the average age of directors); *Majority* (dummy variable equals 1 if the largest shareholder owns more than half of the company); *Private* (dummy variable equals 1 if the main shareholder is an individual or a private company); *Log (Assets)* (the natural logarithm of total assets); *Leverage* (total debts divided by total assets); *Tangible* (tangible assets divided by total assets); and *Fage* (the number of years listed on the stock market).

First, we estimated Equation (1) without any matching techniques. However, we are aware of the endogeneity issues that concern the firm-level and board characteristics (Hermalin and Weisbach 2003, Adams et al. 2010). Following the study by Hope and Wang (2018), we implemented PSM (Caliendo and Kopeinig 2008) before the DID estimation to match firms using the firm and board characteristics in the treatment group with the corresponding firms in the control group. PSM allows for the construction of matched sets with similar distributions of the covariates. After building the matched sets, we estimated Equation (1) again. We are aware of the bias generated if a potentially important cofounder is excluded. Therefore, we compared our PSM results to the results gathered with CEM (Blackwell et al. 2009), an exact matching method using coarsening continuous variables. Furthermore, we opted for the parallel trend assumptions (CPH 2018) to ensure the internal validity of the DID estimations.

4. Empirical Results

Our main results of the DID estimations examining the changes in financial performance following a board chair turnover event are provided in Table 3. Columns 1 and 2 report the DID estimates without any matching method, columns 3 and 4 present the results using the DID estimations with the PSM method, and columns 5 and 6 show the results using the DID with the CEM method.

We find in Table 3 that the coefficients of interaction between *Turnover and Post* β_3 are significantly positive (*p-value* < 0.01 in column 1; *p-value* < 0.05 in columns 5 and 6; *p-value* < 0.1 in columns 2, 3, and 4). The results suggest that financial performance (ROA or ROE) may improve when a COB turnover occurs, which supports our hypothesis that the board chair turnover positively affects the financial performance of Chinese listed firms. In addition, the control variable *Majority* in all the models is positively significant with the dependent variable (ROA

or ROE) at the 1% level. This finding suggests that Chinese listed firms perform better when their major shareholder holds more than 50% shares of the company, following the findings by Kato and Long (2006).

Table 3 The impact of board chairperson turnover on corporate performance

	(1) OLS Model1 ROA	(2) OLS Model2 ROE	(3) PSM Model3 ROA	(4) PSM Model4 ROE	(5) CEM Model5 ROA	(6) CEM Model6 ROE
Turnover	−0.021**	−0.024	−0.001	−0.015*	−0.008	−0.023***
	(−2.26)	(−1.32)	(−0.10)	(−1.85)	(−1.35)	(−2.74)
Post	−0.003	−0.004	−0.011**	−0.007	−0.011**	−0.007
	(−1.23)	(−1.31)	(−2.08)	(−1.09)	(−2.00)	(−0.91)
Turnover X Post	0.028***	0.035*	0.009*	0.014*	0.011**	0.017**
	(2.64)	(1.78)	(1.70)	(1.74)	(2.08)	(2.10)
Bsize	−0.000	−0.000	0.003*	0.001	0.002	−0.001
	(−0.24)	(−0.19)	(1.71)	(0.77)	(1.31)	(−0.58)
Duality	−0.005	−0.004	−0.011*	−0.007	−0.008	−0.012
	(−1.57)	(−1.18)	(−1.93)	(−0.82)	(−1.58)	(−1.39)
Bindep	0.010	0.010	−0.053**	−0.017	−0.011	0.001
	(1.02)	(0.64)	(−2.54)	(−0.51)	(−0.48)	(0.04)
Femdir	−0.006	0.005	−0.041	0.008	−0.032	0.010
	(−0.67)	(0.41)	(−0.98)	(0.35)	(−0.82)	(0.43)
Busydir	0.002	−0.000	0.017*	0.009	0.010	−0.002
	(0.49)	(−0.05)	(1.83)	(0.64)	(0.95)	(−0.16)
Govdir	−0.019***	−0.030***	−0.021	−0.022	−0.023	−0.048***
	(−3.01)	(−2.75)	(−1.52)	(−1.17)	(−1.12)	(−2.68)
Findir	0.018**	0.013	0.049**	0.040**	0.025	0.029*
	(2.25)	(1.17)	(2.05)	(2.01)	(0.95)	(1.66)
Bage	0.000	−0.000	0.000	0.001	0.000	0.001
	(0.77)	(−0.44)	(0.67)	(0.54)	(0.47)	(1.11)
Majority	0.011***	0.029***	0.016***	0.033***	0.019***	0.029***
	(3.11)	(6.41)	(3.05)	(3.86)	(3.24)	(2.99)
Private	0.004	0.005	0.007	0.003	0.009*	0.008
	(1.28)	(0.79)	(1.47)	(0.28)	(1.93)	(0.81)
Log (Asset)	0.006***	0.016***	0.013***	0.015***	0.017***	0.011*
	(2.73)	(7.71)	(5.45)	(2.94)	(6.36)	(1.94)
Leverage	−0.082***	−0.025*	−0.186***	−0.004	−0.191***	0.002
	(−7.17)	(−1.88)	(−4.09)	(−0.16)	(−4.57)	(0.09)
Tangible ratio	−0.035***	−0.085***	−0.038**	−0.117***	−0.019	−0.096***
	(−4.23)	(−7.39)	(−2.32)	(−4.89)	(−1.27)	(−4.27)
Fage	−0.000	−0.001	0.001	0.000	0.000	−0.001
	(−1.09)	(−1.49)	(1.62)	(0.24)	(0.69)	(−0.98)
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Chair turnover	146	146	138	138	119	119
Without chair turnover	967	967	138	138	119	119
R-squared	0.178	0.132	0.238	0.140	0.269	0.156
Observations	9373	9373	2614	2614	2254	2254

Note: The table reports the difference-in-differences multivariate regression with ROA and ROE as dependent variables. Variables include the following: *ROA* refers to return on assets; *ROE* refers to return on equity; *Bsize* (the number of directors on the board); *Duality* (CEO duality); *Bindep* (the proportion of independent directors); *Femdir* (the proportion of women directors); *Busydir* (the proportion of business directors); *Govdir* (the proportion of directors with political background); *Findir* (the proportion of directors with a financial background), *Bage* (the average age of directors); *Majority* (1 if the largest shareholder owns more than half of the company); *Private* (1 if the main shareholder is an individual or a private company); *Log (Assets)* (the natural logarithm of total assets); *Leverage* (total debts divided by total assets); *Tangible* (tangible assets divided by total assets); and *Fage* (the number of years listed on the stock market).
***, **, and * indicate significance at the 1%, 5%, and 10% levels.

Moreover, we check the parallel trends assumptions, indicating that the difference

between the treatment and control groups in the absence of the treatment (COB turnover) should be constant over the period (CPH 2018). Figures 1, 2, and 3 illustrate the results of the parallel trends test for each sample. Only "the sample after PSM" (Figure 2) passes the parallel trends test. Before the cutoff date "year of replacement", none of the coefficients are statistically significant, as expected. Furthermore, we notice a permanent effect of the treatment for one, two, and three years after "year of replacement". We conclude that the DID estimation with PSM is better than other estimations and primarily consider the results from the DID estimation with PSM. The results report a positive impact of the turnover of COB on financial performance of 0.9% on ROE and 1.4% for ROA.

Figure 1 Parallel trends test for samples without any matching strategy

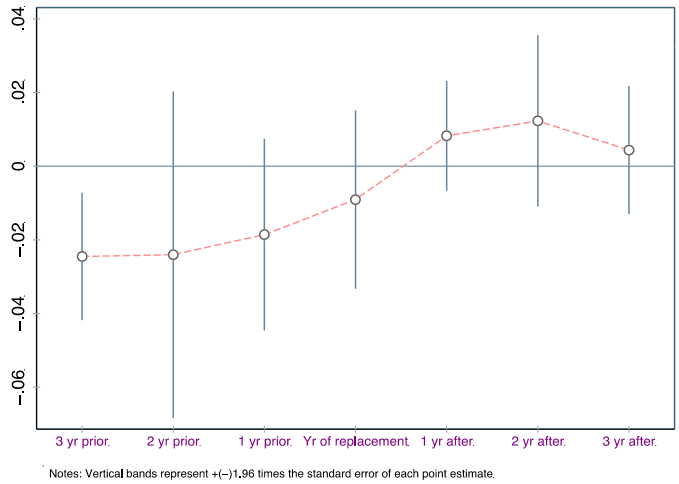


Figure 2 Parallel trends test for samples after PSM

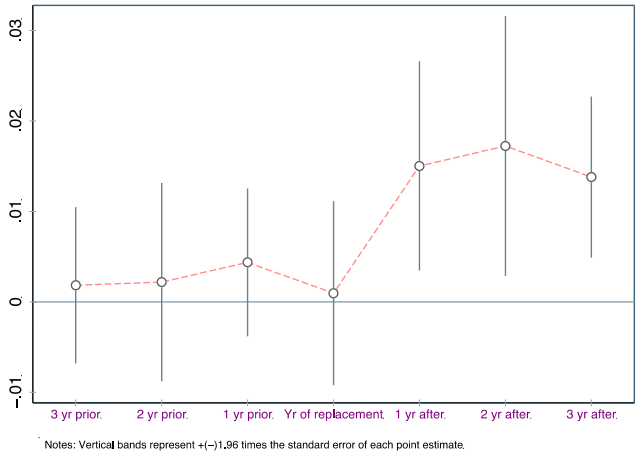
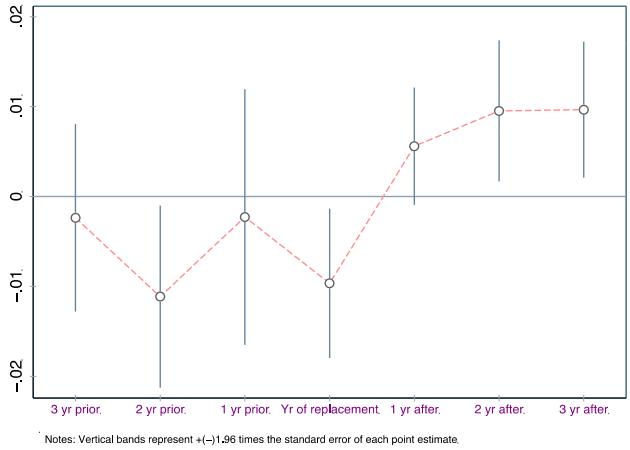


Figure 3 Parallel trends test for samples after CEM



5. Conclusion

In this study, we examine the impact of the turnover of COB on the financial performance of Chinese A-share nonfinancial listed firms from 2008 to 2017. DID with PSM matching strategies report a positive impact of the turnover of COB on financial performance of Chinese firms. Three possible reasons could explain this result. First, the incoming COB in the turnover year could modify the corporate strategy and improve corporate operations (Zhang et al., 2016). Second, the incoming COB could manipulate earnings to convince the stock market with their abilities (Liu and Lu, 2007). Finally, the incoming COB may cancel the tunneling behavior of the previous COB. Considering the control variables, we report a strong correlation between the financial performance of a firm and the existence of a majority shareholder who owns more than half of the firm. Furthermore, we note that the nature of the firm (private majority shareholder or public majority shareholder) has no impact on the corporate financial performance.

To the best of our knowledge, this is the first study to investigate the impact of the COB on the financial performance of Chinese listed firms. Using the turnover events, we address the relation between the COB and financial performance and invite scholars and regulators to study the reasons for this improvement in the financial performance of listed firms. In addition, our novel findings indicate that the COB still plays a prominent role in Chinese firms. Scholars should consider the importance of COBs when studying emerging economies, such as China.

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