Placeholder CEOs

Mario Daniele Amore[a]
Morten Bennedsen[b]
Vikas Mehrotra[c]
Jungwook Shim[d]
Yupana Wiwattanakantang[e]

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a. Department of Management and Technology at Bocconi University. Email: mario.amore@unibocconi.it.
b. Niels Bohr Professor at University of Copenhagen, Denmark and André and Rosalie Hoffmann professor at INSEAD, France/Singapore. CEPR, DFI and ECGI. E-mail: Morten.bennedsen@insead.edu
c. University of Alberta, Edmonton, Canada. E-mail: vmehrotr@ualberta.ca
d. Kyoto Sangyo University, Kyoto, Japan. E-mail: ecoshim@cc.kyoto-su.ac.jp.
e. National University of Singapore Business School, Singapore. EGCI. E-mail: yupana@nus.edu.sg.

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ABSTRACT

Chandler (1984) posits that modern economies naturally converge to managerial capitalism in pursuit of scale efficiencies. This process was first seen in the US in the early 20th century, but then spread to Britain, Germany and Japan as firms in these countries became larger. In this paper we focus on managerial control in family firms and find that in a sizable number of cases, the end result is not a one-way transfer of control to professional managers. Instead, we find that in approximately a quarter of the cases, a transfer of executive control to a professional manager involves a placeholder CEO who manages the firm until the founder's biological heir comes of age to lead the firm. We provide evidence that the placeholder CEO's tenure is marked by policy continuation rather than reversals, and that placeholder CEOs are more likely when the founding family retains board control. We believe this is the first study that documents the prevalence of placeholder CEOs.

We begin by noting that CEO succession is one of the most important decisions in any organization, and especially so in family firms, where the succession decision is highly influenced by the founding family. The family patriarch, who typically stays in the leadership position often past the standard retirement age, needs to carefully plan the succession process to ensure continuity of the business. In most cases, the preferred choice is to pass the baton of control to family heirs.[1] But what would a departing family CEO do if there are no experienced family members that can take the reins as the next CEO?

A case in point is Toyota Motor, the world largest automobile company with the market capitalization of $205.15 billion. In February 2023, the CEO, Akio Toyoda turned 66 after running the firm since 2009. Akio announced his retirement and selected Koji Sato as his successor, while grooming his only son, who is only 33 and working as a senior manager in one of Toyota's subsidiary. Another example is provided by recent succession at Zara. Amancio Ortega is the founder who served as chairman of Spanish fast-fashion group Inditex,[2] which runs the famous brands such as Zara, Massimo Dutti, and Bershka. In January 2011, Amancio turned 76, while Marta, his only daughter from his second marriage, was only 17.[3] By this time Inditex was the world's largest retailer with the market capitalization on $84

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1 This has been documented in several studies of privately-held and listed firms, which show that between one third and half of all incoming CEOs in family firms are drawn from the controlling family.

[2]In Spain, company chairs, especially in family firms, often have executive control of the company, while the CEO acts more as a head of day-to-day operations.

[3]None of his children from his first marriage was involved in the family business.

billion. With no family heirs, Ortega appointed his right hand man -- the incumbent CEO, Pablo Isla (47) as the chair. Isla managed Inditex well but he does not have the one thing that his boss most covets – family blood. In December 2021, when Marta turned 37, Inditex announced that the boss' daughter would replace Isla to become Inditex's chair in April 2022. Amancio took more than 10 years to complete his generational handover process.

These examples highlight a peculiar yet relevant succession model, which has not been studied in the literature, wherein a new CEO serves until the family heir is ready to replace him. Filling this research gap, we explore the appointment of professional managers as CEO in-between two different family CEOs. We show that hiring these professional managers, which we call placeholder CEOs, enable the family to preserve control of the firm for at least another generation and thus ensure the continuity of the family business. Our analysis is novel and unique given that the existing literature has exclusively adopted a binary distinction between family and non-family professional CEOs. We show that not all professional CEOs are the same: some are employed to bring external talent at the top of the company, whereas others are employed as trusted agents that can ensure the continuity of the family by bridging two temporally-distant regimes of family leadership.

Our analysis is based on a unique dataset from Japan spanning more than a half-century, which allows us to study dynastic successions and evolution of family control from the IPO onward. The dataset includes the universe of publicly listed firms in Japan from the period right after World War II, when the stock exchanges were re-open in 1949, until 2015. Our sample includes 1,597 succession events that represent transitions from a founder or founding family CEO.

We define a placeholder CEO as a professional CEO who serves in-between two *different* family CEOs, and has at least one year tenure as the CEO. This restriction allows us to differentiate placeholder CEOs from *interim* CEOs, who are better viewed as CEOs that perform while a search is on for a replacement. As the literature shows, interim CEOs or acting CEOs typically hold the position for only a few months (Ballinger and Marcel, 2010). Instead, we find that placeholder CEOs serve a longer tenure (on average 5 years), consistent with our view that these appointments are made by the family for the sake of making the family heir reach an adequate age to assume the CEO's role. Our data reveal that placeholder CEOs are prevalent in corporate Japan. Specifically, placeholder CEOs account for around 42% of non-family CEOs. Century-old family dynastic firms which have used placeholder CEOs are Kikkoman (est. 1661), Nisshin Seifun (est. 1900), Makita (est. 1915), Ezaki Glico (est., 1919), and Stanley Electric (est. 1920). In Mizkan (est. 1804, vinegar manufacturer), Yuko Nakano (45 years old), who succeeded a professional CEO in 2021, is the ninth generation CEO and the first female CEO in the firm's 200 years of history.

Having documented the diffusion of placeholder CEOs, we ask what type of individual characteristics they possess. Placeholder CEOs appear to be the family's trusted men.

Placeholder CEOs are veterans in the firm, and are older and better educated compared with professional CEOs. In terms of the number of years working with the firm, placeholder CEOs have been with the firm for 26.2 years, which is only slightly shorter than family CEOs (27.9 years), while the mean tenure of professional CEOs is shorter at 21 years. In terms of age, a measure of maturity in the Japanese firms, placeholder CEOs are significantly older, 60.1 years old at the nomination time, whereas the mean age of professional CEOs is 56.7. Family CEOs, however, are much younger than non-family CEOs. The mean age is around 50 years old, for family CEOs who succeed both family and placeholder CEOs.[4]

Placeholder CEOs are more likely to be selected when the patriarch is old, suggesting the biological clock pressure. At succession, the average age of outgoing family CEOs is 68.2 years old, while average retirement age of professional CEOs is 63.6 years old (in line with the Japanese retirement age). The probit model on CEO selection shows performance matters – firms with higher ROA are more likely to select placeholder CEOs as opposed to professional CEOs. We also find that eponymous firms are more likely to select placeholder CEOs. In contrast, when firms do not perform well, as indicated by ROA and debt ratio, they are more likely to select professional CEOs, perhaps to help turn the firms around.

Next, we investigate the role of placeholder CEOs in family firms. The empirical results are consistent with our hypothesis that placeholder CEOs keep the top management seat warm for the family heir. They would maintain the family corporate policy. We test this hypothesis by analysing performance variables in the pre and post succession period, comparing non-family CEOs with family CEOs. Following Mehrotra et al. (2012), we measure performance by ROA and sales growth. The results show that ROA and sales growth of the firms run by placeholder CEOs are not significantly different from the firms run by family CEOs. In contrast, professional CEOs display superior post-performance in terms of ROA.

Review of the literature & our contribution

It is a well-known fact that that successions to professional CEOs are associated with superior performance compared to selecting family CEOs (Perez-Gonzalez, 2006; Bennedsen et al., 2007; Calabrò et al., 2018; Chang and Shim, 2015; Cucculelli and Micucci, 2008). Successions also have a long term effect -- firms run by professional CEOs display superior performance relative to family-run firms (Morck, Stangeland, and Yeung, 2000; Bloom and Van Reenen, 2007; Perez-Gonzalez, 2006; Villalonga and Amit, 2006). This evidence has been interpreted as evidence of nepotism and bias preferences by the founding family despite of having a smaller managerial talent pool (Burkart, Panunzi and Shleifer, 2003; Bertrand and Schoar, 2006; Bloom and Van Reenen, 2007; Mehrotra et al., 2013).

4 This finding indicates that the Japanese firms might consider 50 years old as one of the indicators of a family successor being mature.

This explanation was contested by another set of literature that family firms have longevity because family firms also subject to less agency problems (Anderson & Reeb, 2003). Also, the founding family has social capitals accumulated over generations and high reputation which also appears in the firm name (Mullins & Schoar 2016; Belenzon et al., 2017). Consistent with this argument, Bennedsen et al (2021) studies CEO successions of firms that are run by professional CEOs and shows that the firms which select a family CEO are associated with superior performance compared with those that appoint another professional CEO.

An important concern with the existing studies on the effect of family CEOs versus professional CEOs on performance is that all professional CEOs are grouped as one single type, despite the fact that the group contains interim CEOs, placeholder CEOs, as well as failed CEOs. As a result, it has been difficult to establish whether family CEOs do indeed hurt or benefit firm performance.

Our paper sheds new light on this puzzle by re-investigating CEO succession starting from the founding family. We classify non-family CEOs into placeholder CEOs and professional CEOs. Unlike placeholder CEOs, profession CEOs are succeeded by another professional CEOs, while the founding family is not involved in the top management. Our analysis shows that professional CEOs indeed display superior performance, but only if they are not placeholder CEOs.

Our paper highlights the risk that the family firm literature might have mis-classified placeholder CEOs as professional CEOs. Such mis-classification raises serious concerns in particular on the analysis comparing performance of firms run by family vs. professional CEO. The literature might have shown some wrong results if placeholder CEOs run the firm in the same manner as family CEOs.

Japan is not unique. Placeholders are also prevalent in publicly traded family firms worldwide. In Estée Lauder, Leonard Lauder had run the eponymous firm founded by his mother until 66 years old before passing over to Fred Langhammer in 1999. Four years later, the top job returned to Leonard's 44-years old son, William P. Lauder. Other firms that flip-flopped between family and professional CEOs are namely Barings Bank (UK), H&M (Sweden), Hermes (France), and Michelin (France).

Appendix: Data and Definitions

1. Data sources

Our sample covers all publicly traded firms that went IPO since 1949 until 2010. We follow the firms' CEO succession events that occurred since 1949 until 2015. Following Mehrotra et al. (2013)'s methodology, we define family firms as the firms where the founding family is listed among the top 10 largest shareholders or serves as a board member. An executive is

defined as a family member of the founding family if he is related to the family by blood, marriage, or formal adoption.

To identify family firms, we start by using the ownership databases provided by Mehrotra et al. (2013). We extend their dataset, which ends in 2000, to cover the period until 2015. We obtain The list of top 30 shareholders from 2000 onwards from the Development Bank of Japan The financial data are also obtained from the Development Bank of Japan. The Toyo Keizai database provides the board detailed information including birthday, education (alma mater, major and graduation year), year initially hired, year appointed to the board, year nominated as CEO (*Shacho*) or Chairman (*Kaicho*). We exclude a small number of the firms where financial or ownership data are missing. The final sample covers almost the entire universe of publicly listed firms in Japan from 1949-2015.

Mehrotra et al. (2013) gathered the founding family tree data from various data source to construct the founding family's ownership databases: (1) *Tokiwa Shoin* (1977) provides the family trees of 1002 business leaders, (2) a series of books published by *Zaikai Kenkyusho* (1979, 1981, 1982, 1983, 1985) provides the family tree of publicly listed firms' board, (3) a set of thirty-eight Nihon Keizai Shimbun (2004) volumes provides the biographies of 243 prominent post-war business leaders, (4) commemorative volumes celebrating company anniversaries, (5) Toyo-keizai Shimposha (1995), (6) Nihon Keizai Shimbun (2004), (7) Japanese equivalent of Who's Who published by *Jinjikoshinjo*, and (8) company archives in Koyano (2007). Additional information is obtained from the Nikkei Telecom 21 database of corporate news items published from 1975 onwards in the Nikkei group of newspapers (Nihon Keizai Shimbun, the Nikkei Business Daily, the Nikkei Financial Daily and the Nikkei Marketing Journal) as well as extensive google and yahoo website searches.[5]

Overall, we document a novel CEO type that serves only as a placeholder, keeping the seat ready for the family heir to move in when he is ready.

[5] Family trees of well-known Japanese families in business and politics are available at https://keibatsugaku.com.