

# The Market for CEOs

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**Peter Cziraki**  
University of Toronto

**Dirk Jenter**  
LSE & CEPR



THE LONDON SCHOOL  
OF ECONOMICS AND  
POLITICAL SCIENCE ■

# CEO-firm matching

- Empirical evidence: CEOs matter for firm performance
  - Suggests that efficient CEO-firm matching is important
    - ⇒ **What model best describes this matching process?**
- Models of perfectly competitive & frictionless matching
  - Tervio (2008), Gabaix & Landier (2008)
  - If skill & firm size complementary ⇒ explanation for rise in pay
- Increasing importance of general managerial skills
  - Murphy & Zabojnik (2004, 2007), Frydman (2019), Custodio, Ferreira & Matos (2013)
  - Skills become more transferrable ⇒ explanation for rise in pay

# This study

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

- Most new CEOs have prior connections to the firm
  - **80.4%** of new CEOs are insiders
    - Larger firms – even more internal promotions, fewer outsiders
  - **10.6%** of new CEOs are co-workers of directors
    - ⇒ **>90%** of new CEOs are insiders or co-workers of directors
- Sources of outsider hires:
  - 3.2% of new CEOs raided from CEO positions at other firms
    - Below-CEO executives at other firms (55%), unattached (31%)
- Differences in new CEO pay:
  - Outsiders are more expensive than internal promotions
  - But: Differences small as % of firm value (<\$2m p.a.)

# Interpretation & implications

- Market not well described by models in which firms choose from one unified pool and all skills are general
- To match the data: Firm-specific human capital or asymmetric information
  - Both predict a preference for insiders
  - ASIF needed to explain hiring of “connected outsiders”
    - Directors want to know the candidate (or vice versa)
- Alternatively, boards might not be doing the right thing
  - Agency problems
  - Behavioral biases

# Insiders vs. outsiders

## All firms (1,256 CEO hires)

Internal promotion	External hire
<b>72%</b>	<b>28%</b>

## 1993-1999 (418 CEO hires)

Internal promotion	External insider	Outsider
<b>74%</b>	<b>7.7%</b>	<b>18.7%</b>

## 2000-2006 (515 CEO hires)

Internal promotion	External insider	Outsider
<b>70%</b>	<b>9.3%</b>	<b>21.0%</b>

## 2007-2012 (323 CEO hires)

Internal promotion	External insider	Outsider
<b>74%</b>	<b>7.7%</b>	<b>18.6%</b>

## Connections between directors and new CEO hires

	Outsider hires	
	Number	%
Director connection	69	53
No director connection	61	47
Total	130	

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

# Sources of outsiders

## Outsiders (246 hires)

All outsiders		19.6%	
	Raided CEO	Raided other executive	Unattached
As a % of all hires:	<b>2.8%</b>	<b>10.7%</b>	<b>6.1%</b>

## External insiders (106 hires)

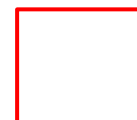
All external insiders		8.4%	
	Raided CEO	Raided other executive	Unattached
As a % of all hires:	<b>0.4%</b>	<b>1.5%</b>	<b>6.5%</b>

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



# Origin firms of raided hires

	Raided other executives		Raided CEOs	
	N	%	N	%
<b>Type of origin firm</b>				
US public	119	77.8%	32	80.0%
US private	28	18.3%	6	15.0%
Foreign public	6	3.9%	1	2.5%
Foreign private	0	0.0%	1	2.5%
Observations	153		40	



# Hiring firms

## By insiders vs. outsiders

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

# Hiring firms

## By source of outsider hire

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

# New CEO pay

## By insider vs. outsider

	Internal promotion		External insider		Outsider	
	Mean	Median	Mean	Median	Mean	Median
Abnormal pay - partial year	476	-371	3,419	1,650	5,269	4,560
Abnormal pay - first full year	162	-362	1,385	1,209	1,683	735

## By source of outsider hire

	Raided CEO		Raided other executive		Unattached	
	Mean	Median	Mean	Median	Mean	Median
Abnormal pay - partial year	4,189	3,263	6,208	6,044	3,948	3,113
Abnormal pay - first full year	1,508	873	1,673	532	1,796	647

# Conclusions

- Firms hire CEOs they are already familiar with
  - There is little reallocation of CEOs across firms
- ⇒ Suggests:
- Firm-specific human capital & personal contacts are of first-order importance
  - The effective hiring pool differs across firms and is small
  - Maybe: rising CEO pay explained by CEOs sharing increasing match-specific rents (?)