As CEOs reach the end of their tenure, they attempt to influence the decision about who will replace them in order to safeguard what they have put in place. This prompts them to favor candidates who share similar demographic profiles whom they believe will carry on where they leave off. We suggest that as CEOs are not usually given the authority to name a successor, they make use of informal power to exert their influence. We test our hypotheses on a sample of 137 CEO successions in 67 German diversified companies between 1985 and 2007 and find strong support for our theoretical reasoning that the more informal power incumbent CEOs have, the greater the demographic similarity between them and their successors. Copyright © 2014 John Wiley & Sons, Ltd.

1. INTRODUCTION

Over the past decades, CEO succession and selection have become topics of major interest in a variety of scholarly fields such as strategy or finance, with much of this literature focusing on CEO successors’ demographic characteristics (Giambatista et al., 2005; Finkelstein et al., 2009). Although the consequences of CEO successors’ demographic characteristics have received considerable attention, still very little is known about the antecedents. In other words, we still lack a profound understanding of why individuals with these particular characteristics are chosen as CEO successors. However, we agree with scholars such as Haveman (1995), Lawrence (1997), and Boone et al. (2004) who reasoned that in order to fully understand the consequences of demographic characteristics, it is imperative to also explore the antecedents of demographic characteristics.

Focusing on the organizational antecedents of CEO successor characteristics, Datta and Guthrie (1994), for example, found that a firm’s research and development intensity was related to CEO successors having a technical background and a higher level of education. Likewise, Ocasio and Kim (1999) found that poorly performing US firms tend to select CEO successors with operations background.

However, given the sociopolitical nature of CEO succession decisions (Cannella and Lubatkin, 1993), it seems reasonable to assume that those being charged with and affected by the selection of CEO successors may have a substantial effect on CEO successors’ demographic characteristics. Nevertheless, we are aware of only one study, the study by
Zajac and Westphal (1996) that to date has directly explored this possibility.

In their landmark study, Zajac and Westphal (1996) argued that sociopsychological processes lead both boards of directors and incumbent CEOs to favor CEO successors with demographic characteristics similar to their own and that the party having more power would be able to win through. In particular, they found that powerful boards of directors were associated with CEO successors’ demographic similarity to the boards of directors. Moreover, their results revealed that outside CEO successors were more likely to be demographically similar to the board of directors and dissimilar to their CEO predecessors.

The objective of the present study is to complement and extend the findings of Zajac and Westphal (1996) and, in doing so, contribute to our understanding of the antecedents of CEO successors’ demographic characteristics. To do so, we give attention to the idea that the generalizability of Zajac and Westphal’s (1996) study on US firms to firms in other advanced economies such as Germany or Japan may severely be limited because of significant differences in the corporate governance systems (Crossland and Hambrick, 2007).

In particular, this study’s intended contribution to the literature is twofold. First, we take an informal power perspective to explore how CEOs influence who will be appointed as their successors. Our core assumption is that incumbent CEOs often want to preserve the legacy they have built up by influencing the choice of a CEO successor (Sonnenfeld, 1986). Therefore, CEOs who are stepping down usually involve themselves in decisions about their successors (Vancil, 1987; Cannella and Shen, 2001). Moreover, we argue that sociopsychological processes lead CEO predecessors to favor CEO successors with demographic characteristics similar to their own. We propose that in the presence of legal constraints, CEO predecessors may be unable to rely on their formal power that directly comes from the authority vested in the firm’s top position but that they have to rely on their informal power accumulated as a result of personal, relational, or situational factors (Greve and Mitsuhashi, 2007) to influence who will be appointed in line with their best interest. Second, we use a German sample consisting of 137 CEO succession events in 67 German firms for the period between 1985 and 2007 to empirically test our hypothesis. The German corporate governance system is a two-tiered board system distinguishing between the management board and the supervisory board. The recruitment and dismissal of the CEO is the responsibility of the supervisory board, in particular the nomination committee that is part of the supervisory board (van Veen and Elbertsen, 2008). By law, no firm executive, not even the CEO, is permitted to sit on the supervisory board. This legal prohibition of CEO duality reduces the CEO’s influence on the supervisory board. In sum, the idiosyncrasies of the German corporate governance system leave CEOs in German stock corporations with no formal power to influence who will be appointed as their successors. Accordingly, the German corporate governance system seems to be particularly suited to explore the informal power perspective.

At this point, it is important to point to an issue often overlooked in the context of power. Research on the relationship between CEOs’ power and strategic decisions has, by and large, modeled and tested direct associations between power and the outcome of the respective decision (Bigley and Wiersema, 2002). However, as we will elaborate in more detail later, power represents simply an ability to bring about an intended effect. Power does not specify the intention. Thus, before elaborating on the theoretical linkage between CEOs’ power and the outcome of strategic decisions, it is necessary to understand CEOs’ intentions of influencing strategic decisions. Accordingly, the theoretical framework we subsequently develop is two tiered. In the first part, we draw on psychological and sociopsychological literatures to argue that incumbent CEOs favor successors with characteristics similar to their own. In the second part, we then turn to incumbent CEOs’ sources of informal power that may enable them to influence the outcome of the successor decision in their best interest.

2. INCUMBENT CEOs’ PREFERENCE FOR SIMILARITY IN A SUCCESSOR

Since the publication of Jeffrey Pfeffer’s (1983) seminal article, academic interest in organizational demography has surged (Lawrence, 1997). Organizational demography refers to the distribution of an organization’s members along one or more demographic characteristics (Pfeffer, 1983). Accordingly, research on organizational demography has typically been conducted on the group or firm level, with the distribution of tenure being the variable of primary interest and a focus on the consequences of demography for organizational outcomes (Williams and O’Reilly, 1998; Boone et al., 2004). Conversely, research on the antecedents of organizational demography has
remained scarce until today (notable exceptions are, for example, Boone et al., 2004; Nielsen, 2009). However, Boone et al. (2004: 634) have underscored the importance of exploring the antecedents of organizational demography in pointing to the fact that replacing outgoing members with newcomers is one important way for an organization to either adapt its course of action or to ensure stability and continuity. In order to fully understand the consequences of demographic characteristics—for example, change or continuity—it is imperative to explore the antecedents of demographic characteristics, asking why individuals with these specific demographic characteristics are selected in the first place.

Theoretical work has long reasoned that social organizations have a tendency to reproduce their own demographic composition. In the words of Pfeffer (1997: 99), ‘demography has a tendency to perpetuate itself’, a tendency to which Kanter (1977: 63) referred to as ‘homosocial reproduction’. Schneider’s (1987) attraction—selection—attrition (ASA) model provides an interesting account of an organization’s tendency to engage in ‘homosocial reproduction’ over time. At the core, the ASA model argues that individuals are attracted to organizations that suit their personal characteristics. At the same time, when screening potential individuals to be hired, organizational members are likely to evaluate similar others more positively and as a consequence are likely to admit new members similar to themselves (Nielsen, 2009). Being selected into an organization that suits their personal characteristics, individuals tend to experience a high degree of job satisfaction and stay within the respective organization, while individuals who do not fit the organization are inclined to leave (Schneider, 1987; Boone et al., 2004). Thus, over time, ‘organizations attract, select and retain an increasingly homogeneous group of employees, who share common backgrounds, characteristics and orientations’ (Nielsen, 2009: 280). Indeed, recent empirical work provides supporting evidence for the ASA model (Schaubroeck et al., 1998; Schneider et al., 1998), suggesting that ‘employers tend to replace organizational members with people who are similar to themselves’ (Lawrence, 1997: 18), especially at the top management level of organizations (Boone et al., 2004; Nielsen, 2009).

The ASA model is suited to explain the tendency toward ‘homosocial reproduction’ on the group or organizational level of analysis. However, the specific objective of the present study was on an individual level of analysis, namely to explore the determinants of demographic similarity between incumbent CEOs and their successors. Similar explanations to the ones proposed by the ASA model on a group or organizational level of analysis come from the similarity attraction paradigm proposed by Byrne (1971). In essence, the similarity attraction paradigm posits that individuals who are similar will be mutually attracted to one another. Several studies have shown that such mutual attraction is likely to lead to biases in decision making (Perry et al., 1999; Goldberg, 2005).

Although initially, Byrne (1971) explored similarity in terms of the attitudes of individuals, subsequent research has shown that easily observable attributes, such as demographic characteristics, are also likely to affect interpersonal attraction. For example, Tsui and O’Reilly (1989) and also Ferris et al. (1994) have shown that supervisors tend to have a positive opinion of subordinates when they share similar demographic characteristics. This is also the case in the evaluation of job applicants by recruiters (Goldberg, 2005; McCarthy et al., 2010). Zajac and Westphal (1996) have shown that the bias in favor of candidates with similar demographic characteristics also holds true in the case of CEO succession. As Zajac and Westphal (1996: 83) have highlighted, deep-seated psychological tendencies may lead an incumbent CEO to favor a demographically similar successor.

Further support for individuals’ tendency to favor demographically similar others comes from social identity theory (Tajfel, 1974). According to social identity theory individuals enhance their self-esteem by seeing themselves as part of a given social environment (Festinger, 1954), which they systematize and simplify by categorizing themselves and others into groups, for example, according to gender, religion, age, or voluntary affiliations, such as memberships in an organization (Ashforth and Mael, 1989). Thus, social identity represents at the same time ‘individual perceptions as well as socially shared and socially constructed conceptions of the defining features and boundaries of the group’ (Postmes et al., 2005: 6). Such categorization and grouping provide personal orientation, a kind of self-referencing, that creates and defines an individual’s place in society and helps to answer, at least in part, who I am (Ashforth and Mael, 1989).

Social groups are made up of individuals who perceive themselves as being in the same social category, sharing an emotional involvement, and achieving a degree of social consensus about the group and their membership in it. According to Tajfel and Turner (1979: 40), ‘Social groups, understood in this sense, provide their members with an identification of
themselves in social terms. These identifications are to a very large extent relational and comparative: they define the individual as similar to or different from, as “better” or “worse” than, members of other groups. Individuals maintain a positive identity by consistently maintaining a more favorable evaluation of group members than outsiders (Goldberg, 2005). Hence, including oneself in a particular social group leads one to see other members of that group more positively than persons outside the group, or put differently, individuals will tend to favor in-group members over non-in-group members.

In sum, both Byrne’s (1971) similarity attraction paradigm and social identity theory postulate that individuals favorably evaluate others who share their group membership, that is, those who exhibit similar demographic characteristics (McCarthy et al., 2010). Hence, applied to the context of the current study, these theories propose that incumbent CEOs are likely to exhibit a preference for similarity in a successor. From this and the fact that that incumbent CEOs often want to preserve the legacy they have built up by influencing the choice of a CEO successor (Sonnenfeld, 1986), we conclude that incumbent CEOs use their power to influence the naming of a successor with demographic traits similar to themselves.

3. HYPOTHESES DEVELOPMENT

Finkelstein (1992: 502) defined power as ‘the capacity of individual actors to exert their will’, and Salancik and Pfeffer (1977: 4) as ‘the ability to get things done the way one wants them to be done’. However, as previous research has argued, in an organizational context, it is useful to distinguish between formal power and informal power. In this context, Greve and Mitsuhashi (2007: 1199) reason

formal power is attached to positions rather than individuals on the basis of an assumption that ‘lower participants recognize the right of higher-ranking participants to exercise power, and yield without difficulty to demands they regard as legitimate’ (Mechanic, 1962: 350). Informal power is gained through possession of resources and information critical to others, knowledge and expertise gained through long tenure, a history of past successes that produce a reputation of power, cooperation with influential outsiders such as board members, and support from subordinates.

In sum then, we can state that formal power comes through decision-making authority directly associated with a specific position and as such is not contingent upon specific circumstances. Informal power, in contrast, is contingent upon specific circumstances as it is typically accumulated as a result of personal, relational, and situational characteristics (Blau, 1964; Pfeffer, 1981). In the following, we focus on the informal power of CEO predecessors. We explore how CEO predecessors’ informal power enables them to influence the choice of their CEO successors’ in their best interest. In other words, how is CEO predecessors’ informal power related to the demographic similarity between CEO predecessors and CEO successors? More specifically, we build on Greve and Mitsuhashi’s aforementioned quote and employ tenure, firm performance, and social capital as indicators of informal power that may enable CEO predecessors to take influence in the successor decision.

3.1. Tenure

Newly appointed CEOs face considerable challenges. First, the top job usually entails significant changes in both responsibilities and in the environment (Kotter, 1982), and, when first appointed, CEOs may not only lack experience but also resources and a favorable reputation. There is often a lot of pressure to adjust to the demands of the job quickly and to develop good working relationships with other powerful inside and outside stakeholders, from members of the top management team (TMT) to those who sit on the board of directors and to customers (Vancil, 1987; Shen and Cannella, 2002). At the same time, CEOs need to hit the ground running if they are to build a consensus behind their own plans (Miller, 1993; Miller and Shamsie, 2001). One solution is to share decision making with other executives and to open extensive channels of communication in an effort to win political support and have access to crucial information (Hambrick and Fukutomi, 1991; Miller, 1993). CEOs are often vulnerable during their early years in the position. They may have rivals among the other executives in the firm, and they know that until they have a chance to prove themselves, the board of directors that appointed them and other powerful stakeholders will need to be convinced of their abilities and be monitoring what they do (Vancil, 1987). In fact, Shen and Cannella (2002) found that CEOs have a higher risk of dismissal during their first 5 years than at any other time in their tenure.
Normally, CEOs stick close to the mandate they are given when they are appointed while they develop a track record, gain legitimacy, and obtain a political foothold, in short, while they establish their authority and consolidate their power (Gabarro, 1987; Henderson et al., 2006). Over time, and assuming good performance, the board of directors and various stakeholders will have more confidence in the appointment that has been made and become less vigilant in their monitoring (Shen, 2003; Cook and Burress, 2013). CEOs may see this as a sign that they may increase their discretion (Hambrick and Finkelstein, 1987) and take steps to extend their power. One of the things they might do is to support the candidature of individuals they would like to see on the board of directors, or at least who they believe would be passive in serving on the board (Westphal and Zajac, 1995). They may also attempt to mold the TMT according to their own needs, promoting individuals they believe will be loyal and supportive and attempting to force out anyone they think would criticize or challenge them (Pfeffer, 1981).

Once initial measures have been taken, the accumulation of power gains momentum, and CEOs will tend to increasingly centralize decision making (Hambrick and Fukutomi, 1991). To do so, they establish control over the channels of communication that deliver the information needed for critical decisions, withholding information when it is to their benefit and making it possible for them to set the agenda for board meetings, thus increasing their power still further (Hill and Phan, 1991). In increasing their scope for action (Hambrick and Fukutomi, 1991), CEOs even become involved in routine details, stretching their authority from strategic to operating decisions (Miller, 1993).

The more CEOs make use of their power, the more they build up a reputation for being powerful, which creates an aura that discourages resistance or opposition. All of this takes time. Hence, authority and legitimacy of CEOs increase with tenure until their power becomes institutionalized (Pfeffer, 1981) to the point that their authority may no longer be questioned and their power is taken for granted to such an extent that other executives no longer contest them (Ocasio, 1994; Shen, 2003). As their position solidifies, CEOs of long tenure are often able to make strategic decisions purely on their own authority, as can be seen by long-tenured CEOs designing their own compensation packages (Hill and Phan, 1991), instituting golden parachutes for themselves (Singh and Harianto, 1989), and insulating themselves from any consequences of poor performance (Wowak et al., 2011).

In sum, long tenure is generally associated with greater power, and that power can be used to influence strategic decisions, some of which can directly benefit the CEO, the selection of a successor included (Boeker and Goodstein, 1993). Considering this, and also the assumption that sociopsychological processes lead incumbent CEOs to exhibit a preference for similarity in succession decisions, we propose the following:

**Hypothesis 1:** The longer the tenure of the incumbent CEO, the greater is the similarity between predecessor and successor.

### 3.2. Performance

Daily and Johnson (1997) have shown that firm performance is an antecedent to CEO power. Reviews of the CEO succession literature show that the consensus is that the rate of CEO turnover is negatively associated with firm performance and that the probability of CEO turnover increases when performance declines (Fizel and Louie, 1990; Giambatista et al., 2005; Neumann and Voetmann, 2005). There are a variety of explanations for why, and how, firm performance is linked to CEO power.

First, agency theorists have argued that CEOs will attempt to maximize their own utility at the expense of the shareholders’ utility (Jensen and Meckling, 1976; Eisenhardt, 1989a). Such thinking legitimizes the need for boards of directors to exert control over CEOs; indeed, some have argued that the primary role of boards is to check CEO opportunism and ensure that top executives act in the best interest of shareholders (Fama and Jensen, 1983). As good performance increases shareholder utility, the members of the board take it as an indication that the CEO is acting in the best interest of shareholders and, as a result, will less closely monitor the CEO’s actions (Lorsch and Maclver, 1989; Shen, 2003; Cook and Burress, 2013). Thus, good performance can lead to an increase in CEO discretion, and, in turn, an increase in power. On the other hand, poor performance can cause a downward spiral in CEO power (Ocasio, 1994). Poor performance undermines the confidence of members of the board in the selection they have made. They may also see their own reputations, and hence their own job prospects, as being at risk because poor performance may be attributed to their inadequate monitoring (Fama, 1980). This, however, will lead them to increase their scrutiny of the CEO, reducing the CEO’s discretion, and, as a result, his or her power.
Secondary, good performance may add to the charisma of a CEO (Waldman and Yammarino, 1999; Agle et al., 2006). Charismatic CEOs are trusted. Others will be personally attracted to them, share in their beliefs, and have confidence in their abilities. As Tosi et al. (2004: 406) put it, ‘charisma is based on the feeling of oneness that a person has with another, the desire for that feeling, or the personal attraction to be like the other; the stronger the attraction, the stronger the power’. This is consistent with the notion of romanticized leadership (Meindl et al., 1985), whereby a charismatic CEO has the ability to influence organizational members. The effect of CEO charisma is not limited to the firm’s internal environment. CEOs represent their firm to outside stakeholders. They engage in politics and are the firm’s face vis-à-vis public institutions and other firms (Pfeffer and Salancik, 1978). As Fanelli and Misangyi (2006: 1053) noted, CEO charisma serves to increase identification among external stakeholders with CEOs and, by extension, their organizations. Charismatic CEOs are thus able to extend the reach of their power to external stakeholders. Just as good performance bolsters the charisma of a CEO, poor performance undermines the extended reach of their power to external stakeholders. They engage in politics and are the firm’s informational nerve center for performance by B. If A holds a large number of these credit slips, for a number of persons with whom A has relations, then the analogy to financial capital is direct. These credit slips constitute a large body of credit that A can call in if necessary—unless, of course, the placement of trust has been unwise, and these are bad debts that will not be repaid.

Over the years, CEOs are likely to build up a considerable number of reciprocal obligations, especially among members of the TMT. As the central decision maker, the CEO has a say in all of the firm’s substantial strategic issues. Although they may not be responsible for each and everyone, CEOs usually have the power to veto the initiatives of TMT members, and they also usually control the purse strings. CEOs also are at the apex of the firm’s informational nerve center (Pfeffer, 1992; Barkema and Pennings, 1998). This gives them an informational advantage and, as we have noted, the right to set the agenda of meetings. Thus, CEOs are in a position to supply team members with critical information, and they can set the agenda in a way that is useful to, or could hurt, one of them (Coleman, 1988). In sum, it is in the interest of CEOs to win the loyalty of members of the TMT. However, it is reasonable to assume that not all TMT members will be loyal to the CEO when it comes to the selection of a successor.

On the one hand, the TMT encompasses members who were appointed by the incumbent CEO. In other words, the incumbent CEO was not only responsible for them joining the TMT but also for their gain in

3.3. Social Capital

Obviously, CEOs do not run firms alone. They are usually part of a TMT, the members of which have clearly defined roles and responsibilities (Hambrick, 1994). As such, they are embedded in a network of personal relationships (Granovetter, 1985: Qing et al., 2006). The position of the CEO within these relationships provides them with the power of social capital (Coleman, 1988), the ‘goodwill that is engendered by the fabric of social relations and that can be mobilized to facilitate action’ (Adler and Kwon, 2002: 17). Individuals may use that goodwill in their own best interest. Coleman (1988: S102) puts it as follows:

If A does something for B and trusts B to reciprocate in the future, this establishes an expectation in A and an obligation on the part of B. This obligation can be conceived as a credit slip held by A for performance by B. If A holds a large number of these credit slips, for a number of persons with whom A has relations, then the analogy to financial capital is direct. These credit slips constitute a large body of credit that A can call in if necessary—unless, of course, the placement of trust has been unwise, and these are bad debts that will not be repaid.

All this suggests that there is a positive relationship between firm performance and CEO power. Therefore, the temporal coincidence of good recent firm performance and CEO succession decision may provide the incumbent CEO with a distinct source of informal power to influence the CEO succession decision in his or her own best interest. Considering this and an incumbent’s preference for similarity in succession decisions, we propose the following:

Hypothesis 2:
The better the performance of the firm under the incumbent CEO, the greater is the similarity between predecessor and successor.
Hence, the environment (Chakravarthy, 1982; Miller, 1991) causes changes in the environment through the choice of an appropriate strategy and the design of a matching structure (Andrews, 1971; Wiersema, 1992). However, as argued already by Ansoff (1979), the process of alignment is aggravated by the fact that the firm’s environment undergoes constant change, resulting in the need for continuously adapting the firm to its changing environment.

A prerequisite for alignment is that the firm, in particular the CEO, is able to learn, unlearn, or relearn on the basis of past behaviors (Hedberg, 1981; Tsang and Zahra, 2008). The degree to which the firm is forced to do so is thereby contingent upon the degree of environmental change. In relatively stable environments, the pressure is rather low, as the knowledge possessed today will, to a fair degree, also apply tomorrow. Conversely, in dynamic environments characterized by substantial changes, the knowledge possessed today is likely to become severely obsolete and inappropriate tomorrow (Henderson et al., 2006). Thus, to the degree that an environment changes, novel knowledge is required to sustain the firm–environment alignment (Nyström and Starbuck, 1984).

Research has shown that CEOs (and indeed all individuals) employ mental models in order to cope with their information environments (Walsh, 1995). These mental models are abstractions of, for example, how the environment behaves, what strategic choices are feasible, and how the firm should be run. The important thing here is that these mental models are typically based on the past, are finite, and are relatively fixed (Kiesler and Sproull, 1982; Henderson et al., 2006). The rigidity of mental models, however, implies that it may be difficult for CEOs to unlearn and relearn even if environmental conditions exert pressure to do so (Virany et al., 1992) and, consequently, that the misalignment between firm and environment increases over time.

Substantial support for the assertion that CEOs typically have difficulties adapting to changing environments comes from both the theoretical and empirical literature. For example, in developing a dynamic model of CEO tenure, Hambrick and Fukutomi (1991) have convincingly argued that once a CEO has aligned a firm with his mental model, he or she will engage in fewer and fewer substantive initiatives, leading to a lowering of the firm’s adaptive properties. Similarly, the empirical literature found that CEOs become ‘stale in the saddle’ (Miller, 1991), become ‘obsolete’ (Henderson et al., 2006), and enter a ‘decline stage’ (Miller and Shamsie, 2001) largely because of their finite and relatively fixed mental models.

On the other hand, the TMT also encompasses members who were on the team prior to the CEO. Given that TMTs tend to consist of individuals that are relatively aggressive and achievement oriented (Hambrick, 1994), these TMT members may see the CEO as a rival rather than a mentor. Having the ambition to become CEO themselves and having lost out to the CEO in the previous selection process, it is unlikely that they will be loyal to the CEO in terms of supporting the CEO’s choice for a successor. Accordingly, whether the CEO possesses sufficient social capital to influence the choice of a successor in his or her best interest is likely to depend upon the composition of the TMT. Therefore, we hypothesize the following:

**Hypothesis 3:**

The greater the proportion of TMT members appointed by the incumbent CEO during his tenure to those TMT members being in place prior to the incumbent CEO taking office, the greater is the similarity between predecessor and successor.

So far, we have exclusively focused on incumbent CEO’s informal power. Subsequently, we broaden our perspective to explore how environmental change may affect incumbent CEOs’ ability to influence the selection of their successors. As such, we explicitly give rise to the idea that the selection of CEO successors may be subject to continuous tension between incumbent CEOs’ preferences and factors outside the boundaries of the firm.

### 3.4. Environmental Change

It has long been argued that in order to ensure long-term survival and growth, a firm must align with its environment (Chakravarthy, 1982; Miller, 1991). Hence, the firm—most notably the CEO—copes with changes in the environment through the choice of an
Admittedly, it may also be argued that CEOs with long tenure will be more prone to initiate strategic change, because as Zuniga-Vicente et al. (2005: 259) have reasoned, CEOs with long tenure have had time to develop a broader knowledge base for dealing with the new environmental threats as a direct consequence of their greater accumulated experience. In this situation, the history and past practices of CEOs may be exploited to solve the problems that new environmental conditions typically involve, rather than inhibiting the actions that ought to take.

Although this reasoning seems plausible, the overwhelming majority of research is in support of the notion of CEOs’ mental models rigidity, including the resulting misalignment between firm and environment. Given that a misalignment between firm and environment may lead to severe consequences, the context of CEO succession provides a unique possibility to introduce new knowledge and, by that, new perspectives and new ties to the firm’s environment (Nystrom and Starbuck, 1984).

As we have argued earlier, the incumbent CEO is likely to make use of his or her power to influence the appointment of a CEO successor in a way that a successor with characteristics similar to his or her own is selected. Similar characteristics, however, imply similar mental models and as such similar perspectives on what strategic choices are feasible and how the firm should be run (Hambrick and Mason, 1984; Boone et al., 2004). Thus, whereas the incumbent CEO strives to appoint a successor with similar characteristics, environmental changes call for the opposite: the appointment of a successor with dissimilar characteristics and, by that, new knowledge and new perspectives (Nystrom and Starbuck, 1984; Gupta, 1988; Virany et al., 1992).

Environmental changes may thus weaken an incumbent CEO’s power base (Ocasio and Kim, 1999). Whereas in times of environmental stability the incumbent CEO’s power may bolster him or her from contesters, in times of environmental change, his or her qualities may be questioned and the power base, and by that his or her influence in the successor selection process, may fade. In sum, the degree to which an incumbent CEO may influence the appointment of a successor CEO may depend not only upon his or her power but also upon the degree of environmental changes. Therefore, we have the following hypothesis:

**Hypothesis 4:**
The relationship between an incumbent CEO’s informal power and the similarity between predecessor and successor is moderated by the degree of environmental change. Specifically, in high-change environments, the effect of informal power on similarity is likely to be lower than that in low-change environments.

### 4. METHODOLOGY

#### 4.1. Sample and Data Collection

We tested our hypotheses using a pooled data set of CEO successions at German firms listed on the HDAX index of the German stock exchange that took place between 1985 and 2007. Given that no comprehensive database that captures the information needed for our research is available, we drew on data from multiple sources. We began with firms’ annual reports, which allowed us to gather information on all of the CEO successions that had taken place during our time window. We obtained demographic data on the CEOs and information on their career paths from Hübner’s Who is Who, the Lexis Nexis online database, Sutter’s International Red Series Who’s Who in Germany, and the Munzinger online archive. Remaining gaps were closed, and the reliability of the data we uncovered was verified, through direct contact with the firms. In a few cases, the information we were seeking could not be found in firm archives, so we contacted the individuals directly. Overall, we ended up with complete background information for 137 incumbent–successor CEO pairs in 67 firms.

In the same way, we were able to determine the composition of the TMT at each firm. Financial data were taken from Thomson Reuters Datastream, whereas information on industry and foreign direct investments were obtained from the EUKlems and UNCTAD databases.

#### 4.2. Dependent Variable

Previous research has shown that biographic similarity based on information taken from resumes is likely to be subject to in-group bias (Zajac and Westphal, 1996; Zhang et al., 2011). Thus, we created a measure of similarity based on four different observable demographic characteristics that can be found in the resumes of CEOs, namely educational background and functional, industry, and international experience (Wiersema and Bantel, 1992; Boeker, 1997;
Herrmann and Datta, 2002). Whereas past research has used a variety of different demographic variables to explain management behavior, we chose to use these more widely used variables. On the one hand, we ensure comparability with prior research (cf. reviews by Kesner and Sebora, 1994; Giambatista et al., 2005). On the other hand, these four variables would all be variables that CEOs would know of their peers, as they are work related and not too private to be shared in a work environment, during small talk, and during discussions with peers and colleagues. Furthermore, all four variables are salient characteristics, which are the basis for psychological group categorization (Stangor et al., 1992).

Each component of the similarity measure was calculated separately and then combined into a composite measure through addition. Because the scales of the four similarity indicators are different, we standardized the indicators by dividing the value of each succession pair by the maximum value of all succession pairs. The standardization limited all four indicators to values between 0 and 1 and thereby ensured that all four similar indicators are equally important. The similarity indicators were calculated as follows.

We measured educational similarity by comparing the field of study and apprenticeship of the incumbent and the successor. We used Bunge’s (1967) system of sciences, which clusters scientific fields into different groups and shows the degree of relationships between them. For instance, if both CEOs studied business, they would obviously be similar in terms of their education. If one studied business and the other economics, there would be a difference, but a smaller one than if one studied business and the other physics. The distance measure we applied is similar to the diversification measure applied by Haleblian and Finkelstein (1999). We used a hierarchical classification according to which distances increase with the increase of level of intercept point between discipline categories, as shown in Figure 1. The distances we applied as follows: 0 for the same field of study, 1 for the intercept at the first level, 2 for the intercept at the second level, and so on.

To assess functional, industry, and international experience similarity, we relied on an adapted Euclidian distance measure of the kind used in previous research (Wagner et al., 1984; Westphal and Zajac, 1995). Our measure enabled us to compare multiple values of a specific demographic characteristic for each CEO pair. Taking into account that incumbent and successor CEO may well have made different career steps and that they may have spent appreciably different amounts of time in those steps, we were able to accurately assess the similarity between incumbent and successor CEO. In particular, we assessed the similarity between incumbent and successor CEO as follows

$X_i = \frac{1}{n} \left( A_i + B_i \right) \times \left( \frac{1}{n^2} \sum_{i=1}^{n} (A_i + B_i) \right)$

with $A_i (B_i)$ being the number of years an individual had spent in function, industry, or country $i$ and $n$ being the total number of functions, industries, and countries.

At this point, a note on our measures is in order. The measures calculate the distances between the incumbent and successor CEOs. In other words, they show larger values the more dissimilar the pair is, thereby reflecting the dissimilarity between the two individuals. Because we are interested in the similarity and not the dissimilarity, we multiplied the composite measure by $-1$.

![Figure 1. System of sciences (adapted from Bunge, 1967).](image-url)
To measure functional background similarity, we used a functional classification comparable with that of Hambrick et al. (1996) and evaluated the functional backgrounds of each CEO pair. We considered the functions in which each incumbent and successor had worked and over how many years. We then compared the function–duration portfolio using the measure described earlier. We measured industry background similarity using the first two digits of the primary industry of the companies in which the incumbent and the successor had worked over the course of their careers and the number of years they had spent in each of those industries. We calculated international experience similarity along the same lines, looking at the time spent by the individuals outside Germany. We used country clusters similar to that of Rugman and Verbeke (2004) to take into account that countries may not be equally distant to each other in terms of their cultures.

4.3. Independent Variables

Our variable incumbent CEO tenure is simply the number of years that the incumbent CEO held the top job. Good performance is a relative concept. Therefore, we measured firm past performance using the percentage change in return on assets (ROA) over the 2 years prior to the naming of the new CEO (Fredrickson et al., 1988; Huson et al., 2001). Looking at the change in ROA allows us to account for the fact that the expected ROA in some industries would be seen in others as quite good, and in still others as unsatisfactory. A window of 2 years takes in past performance and yet, as Fredrickson et al. (1988) have elaborated, is recent enough to serve as a reasonable frame of reference. To gauge social capital, we calculated the relative portion of members of the TMT appointed by the incumbent CEO over the portion of members of the TMT not appointed by the incumbent CEO (Zajac and Westphal, 1996).

4.4. Moderation Variables

We operationalized environmental change as change in foreign direct investment (FDI) across a firm’s portfolio of businesses. We followed Hutzschenreuter and Gröne (2009) and calculated the change in the business-segment-sales-weighted average FDI across a firm’s business segments to represent environmental change—most notably foreign competition—across the firm’s entire portfolio of businesses. The variable thereby specifies size of investments of foreign firms in Germany, broken down by industries.

4.5. Control Variables

The variable succession reason indicates the initiating force of the CEO succession event (Friedman and Singh, 1989). Following the customary distinction in the literature (Fredrickson et al., 1988), we used a dummy variable, which was 1 for forced succession and 0 for regular succession. In many cases, the incumbent CEOs do not fully depart the scene but are retained within the firm, for example, as member of the board (Quigley and Hambrick, 2012). Therefore, we included the control variable transition to the supervisory board. We used a binary variable that takes the value of 1 if the incumbent CEO took a position on the supervisory board following the succession event, 0 if not. Following previous research, we also controlled for the origin of the successor (Wiersema, 1992). The control variable inside succession was coded 1 if the successor CEO had worked at least 3 years for the focal firm, 0 if not (Cannella and Lubatkin, 1993).

We used ROA in the year before the succession event to gauge firm performance, assuming that well-performing firms would be less likely to rock the boat by altering the kind of CEO they choose, while poorly performing firms may try a new kind of CEO in the hope of a turnaround (Shen and Cannella, 2002). We used ROA because it has the advantage of controlling for differences in financial structure and being relatively resistant to the financial manipulations of management (Gómez-Mejia and Palich, 1997). We used a firm’s sales in million Euros as a proxy for firm size. We controlled for change in firm size to account for the fact that firms grow at different rates, which, in turn, may require different CEOs.

Along the same lines, we included change in cultural diversity and change in product diversity to acknowledge that differences in cultural and product diversity may call for different CEOs. To control for change in cultural diversity, we used a 2-year window. Our cultural diversity measure is based on the weighted average relatedness measure used by Teece et al. (1994), which we calculated as the sum of cultural distances between all pairs of a firm’s subsidiaries.
divided by the total number of pairs. We calculated cultural distance using the Kogut and Singh (1988) index based on Hofstede’s (1980) scores and the GLOBE dimensions. Despite its extensive use in the international business literature (Gómez-Mejia and Palich, 1997), Hofstede’s four cultural dimensions have been subject to criticism. To address these concerns, we complemented this index with scores for the nine cultural dimensions identified in the GLOBE projects (House et al., 2004). We computed change in product diversification using the Berry–Herfindahl index (Berry, 1971) used in previous research, for example, (Mahoney and Pandian, 1992). This allowed us to take into account changes in the breadth of a firm’s business portfolio during the 2 years prior to a succession.

5. DATA ANALYSIS AND RESULTS

We used OLS multiple regression to test our hypotheses. Table 1 shows the descriptive statistics for the dependent, independent, and control variables. Taking into account only those variables that appear in the same regression model, none of the correlation coefficients is greater than 0.4 and therefore below the critical threshold level of 0.8 (Kennedy, 2008). Given that the variance inflation factors for all variables are below 1.4, they are considerably lower than the generally accepted critical value of 10 (Tan and Tan, 2005), indicating that our results are not driven by multicollinearity. We used the Huber/White sandwich estimator because Breusch and Pagan (1979) and Cook and Weisberg (1983) tests revealed the presence of heteroskedasticity.

Table 2 shows the results of the regressions explaining similarity between incumbent and successor CEO. Model 1 shows the control model. In Hypothesis 1, we argued that the longer the tenure of the CEO stepping down, the greater the similarity between predecessor and successor CEO. We receive support for this hypothesis, as the coefficient in Model 2 is positive (0.175) and significant at the 1% level. In Hypothesis 2, we predicted that when a firm has performed well under a CEO, the CEO’s successor will share similar characteristics. We receive strong support for this hypothesis. In Model 3, the coefficient is positive (0.269) and significant at the 1% level. In Hypothesis 3, we argued that a higher relative share of TMT members appointed by the incumbent CEO would lead to greater similarity. This hypothesis is partially supported. In Model 4, the coefficient is positive (0.503) and significant at the 1% level. However, the full model (5) does not show support for Hypothesis 3, which leaves us with mixed results for Hypothesis 3. Finally, in Hypothesis 4, we argued that environmental change negatively moderates the effect of CEO tenure, past performance, and social capital on similarity. Model 5 is the full model including the interaction effects. The results reveal that our hypothesis receives only partial support. Whereas the interaction coefficients for tenure and social capital are insignificant, the coefficient for the interaction term between past performance and environmental change is significant at the 5% level. This may indicate that changes in a firm’s environment are likely to have an attenuating effect on a CEO’s informal power derived from past performance, yielding less similarity in the CEO’s successor.

6. DISCUSSION

We set out with this study to further our understanding of one of the most crucial decisions any company will make—the selection of a CEO. Our study contributes to theory development by explicitly addressing an important yet previously under-researched question: why are individuals with particular characteristics chosen as CEO successors? To answer this question, we adopted a behavioral perspective and built on the core assumption that incumbent CEOs-driven by socio-political and sociopsychological processes—influence the choice of a successor in an attempt to safeguard what they have built by seeing that they are replaced by someone similar to themselves and that they use whatever power they have to do that.

In the only study we are aware of addressing the question at hand, Zajac and Westphal (1996) found that the demographic characteristics of CEO successors depend on the relative power of CEOs vis-à-vis their boards. More powerful boards are more likely to name a successor whose demographic characteristics better fit the demographic profiles of members of the board than the incumbent CEO. Although this study’s contribution is undeniable, the relative board power perspective may only apply in specific corporate governance systems, such as the system in the USA. Therefore, in this study, we give attention to the idea that the generalizability of Zajac and Westphal’s (1996) study to firms in other advanced economies such as Germany or Japan may be limited because of significant differences in the corporate governance systems (Crossland and Hambrick, 2007). By exploring how CEOs of German firms would lead to greater similarity. This hypothesis is partially supported. In Model 4, the coefficient is positive (0.503) and significant at the 1% level. However, the full model (5) does not show support for Hypothesis 3, which leaves us with mixed results for Hypothesis 3. Finally, in Hypothesis 4, we argued that environmental change negatively moderates the effect of CEO tenure, past performance, and social capital on similarity. Model 5 is the full model including the interaction effects. The results reveal that our hypothesis receives only partial support. Whereas the interaction coefficients for tenure and social capital are insignificant, the coefficient for the interaction term between past performance and environmental change is significant at the 5% level. This may indicate that changes in a firm’s environment are likely to have an attenuating effect on a CEO’s informal power derived from past performance, yielding less similarity in the CEO’s successor.

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Table 1. Descriptive Statistics

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n = 137. ***p < 0.001, **p < 0.01, *p < 0.05, p < 0.10.

Analyze the data and provide a summary of the findings, focusing on the influence of CEO similarity, incumbent CEO tenure, change in company past performance, social capital, succession reason, inside successor, reoccurring succession, company performance, company size, change in company size, change in cultural diversity, and change in product diversity. Discuss the implications of these findings in the context of CEO succession and corporate governance.
on any indicator of informal power (Virany et al., 1992; Henderson et al., 2006).

One possible explanation for the nonfindings regarding Hypothesis 4 may come from the demands that go along with changing environments. Rapidly changing environments urge firms to make fast decisions (Eisenhardt, 1989b). As Bogner and Barr (2000: 218) have reasoned, ‘rapidly changing environments undermine the usefulness of prolonged consideration of decision alternatives’. However, the ability to make fast decisions in the context of CEO succession is severely hampered by the fact that almost every second firm does not possess a CEO succession plan (Davis and Nosal, 2009). But, without a succession plan at hand, the succession process is considerably prolonged. Therefore, it may be that firms facing the pressure of changing environments pay more attention to the speed of replacement rather than to the distinct qualification of the successor, as reflected in his or her demographic characteristics. In sum, we believe that more research is needed that explores the opposed effects of incumbent CEOs power and environmental change on the choice of successor CEOs.

7. LIMITATION AND FUTURE DIRECTION AND PRACTICAL IMPLICATIONS

No single study can embrace all aspects of an issue. We acknowledge here the limitations of ours. First, the generalizability of our findings may be limited because of the nature of our sample, being made up of large publicly owned firms. The availability and quality of data were an overriding consideration, and although it might be argued that our findings may not be unconditionally transferable to small and privately held firms, it is also true that we would not have been able to obtain the same data from them. Second, although we argue that CEOs actively engage in political processes by exercising their power, our longitudinal large-sample study design does not allow us to directly observe the political processes that ultimately lead to the succession decision. Third, we used a composite measure of similarity consisting of four different demographic variables. However, this measure may not fully capture how incumbent CEOs perceive similarity. Again, the longitudinal large-sample study design prevented us from performing in-depth analyses on the personality and cognition of the incumbent CEO necessary to obtain such information.

Future research may be able to address some of these shortcomings. By contrasting the effects CEO power has in varying organizational contexts with regard to, for example, corporate governance systems or national cultures, we may be able to begin to better understand the why of CEO predecessor–successor similarity. With regard to the generalizability across different corporate governance systems, future research may address the research question at hand in yet other corporate governance systems. By striving to identify sources of power that are independent of any corporate governance system, it would then be interesting to see, for example, whether the results hold for different national cultures. Likewise, it may also be of interest to explore whether the extent to which a CEO may influence the successor decision is driven by sources of power that are independent of the corporate governance context, or whether incumbent CEOs primarily make use of corporate governance-specific sources of power.

Contrasting high-discretion and low-discretion environments, we may also gain additional insights into the degree to which CEOs can apply their power to influence the CEO selection decision. There may be other factors that also affect the choice of a CEO, such as the presence of founder board members, the firm being family owned, and the firm’s geostrategic and political importance to name a few. Political considerations too can play a role. We saw this when Germany and France jointly decided on the selection of a CEO for EADS, the aeronautic, defense, and space giant. In many of these cases, the incumbent CEO may be unable to leverage his power no matter what.

We have looked at similarity that might be reflected in a resume. Future research might also explore other dimensions of similarity. Oftentimes, successors are already known to the incumbent CEO, and the old-boys network may impinge on the selection. Although prior studies have included Ivy League university degrees as a form of group membership, scholars may also include club memberships such as country clubs, political party affiliation, or student club memberships as an indicator to how much selection decisions are based on similarity attraction biases. In sum, there seems to be no shortage of potential research questions that help explain why individuals with particular characteristics are chosen as CEO successors and how the answers to this question vary across different contexts.

For the practitioner, the results of this study imply that incumbent CEOs are likely to try to influence the choice of their successor. Especially those CEOs with long tenure and a track record of good company
Table 2. CEO Dissimilarity Drivers (Composite Measure)

<table>
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<tr>
<th>Variables</th>
<th>Model (1)</th>
<th>Model (2)</th>
<th>Model (3)</th>
<th>Model (4)</th>
<th>Model (5)</th>
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<td>SE</td>
<td>Coefficient</td>
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<td>(0.057) **</td>
<td>0.269</td>
<td>(0.092) **</td>
<td>0.503</td>
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<td><strong>Moderations</strong></td>
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<td>Incumbent CEO tenure * environmental change</td>
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<td><strong>Controls</strong></td>
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<td>Succession reason</td>
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<td>0.184</td>
<td>(0.094) *</td>
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<td>(1.045)</td>
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<tr>
<td>Inside successor</td>
<td>0.189</td>
<td>(0.090) *</td>
<td>0.170</td>
<td>(0.091)</td>
<td>0.193</td>
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<tr>
<td>Succession reoccurrence</td>
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<td>(0.797)  3</td>
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<td>(0.969)</td>
<td>0.345</td>
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<tr>
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<td>(0.698)</td>
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<td>0.006</td>
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<td>(0.167)</td>
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<td>Change in cultural diversity</td>
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<td>Change in product diversity</td>
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<td>0.084</td>
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Robust standard errors in parentheses; n = 137.

*a*Coefficient and standard error have been multiplied by 10,000.

*b*Coefficient and standard error have been multiplied by 10.

*c*Coefficient and standard error have been multiplied by 100.

*d*Coefficient and standard error have been multiplied by 1000.

**p < 0.001, ***p < 0.01, *p < 0.05, †p < 0.1.
performance will be able to exert influence to select successors who are similar to them. Although a similar successor must not be bad for the company per se, companies that are wishing to break with old strategies and that wish to perform more radical changes may be looking for a successor with different characteristics (Hutzschenreuter et al., 2012). Those in the position to appoint new CEOs should be aware of the sphere of influence of the departing CEO and focus in their decision on their vision for the company’s future. Similarly, those practitioners who are evaluating strategic moves of the company from external perspective can benefit from this study’s findings as they obtain indications of whether the company will remain on its current path, or whether changes may be expected after a new CEO has been selected.

Acknowledgement

The authors would like to thank two anonymous reviewers as well as Editor in Chief Antony Dnes for his editorial guidance.

ENDNOTE

1. We thank an anonymous reviewer for pointing out this important issue.

REFERENCES


