How a company's consistent earnings can get a CEO fired

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When a corporation's earnings are steady, its board of directors is more likely to fire their CEO after a bad earnings period, according to new research from the University at Buffalo School of Management.

Recently published in *Management Science*, the study analyzed corporate earnings persistence—whether or not the earnings of a company are expected to recur or not—and how it impacts CEO turnover.

"Firms with high earnings persistence understand that the performance in the current period is likely to carry forward with the incumbent CEO, so they're more likely to fire a CEO who yields poor earnings," says the study's lead author Inho Suk, Ph.D., associate professor of accounting and law in the UB School of Management. "In contrast, boards of firms with low earnings persistence are less likely to fire a CEO with a poor performance because it's likely temporary."

The researchers analyzed data of more than 1,500 CEO turnovers from 1993-2017, measuring earnings performance by industry-adjusted return on assets (IAROA), with the three-year average of IAROA, industry-adjusted ROA changes and non-Generally Accepted Accounting Principles (GAAP) earnings as alternative measures.

Their results show that earnings persistence is the most direct and dominant earnings attribute in explaining CEO turnover decisions.

"Compared to CEO compensation, turnover decisions have longer-term consequences on firm performance and corporate policies," says William Kross, Ph.D., professor of accounting and law in the UB School of Management. "Failure to replace a poorly performing CEO, or to retain a CEO with potential, is the costliest manifestation of agency conflicts."

More information: Inho Suk et al. CEO Turnover and Accounting Earnings: The Role of Earnings Persistence, *Management Science* (2020). DOI: 10.1287/mnsc.2019.3559

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