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CEO Turnover and Financial Distress Recovery: Evidence from China

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Abstract: This paper investigates whether CEO replacement is a successful tool that can help distressed firms recover. This paper uses non-financial data of Chinese firms. Distressed Chinese firms are proxied by special treatment (ST) firms. Successful recovery or CEO replacement means the new CEO helps ST firms recover within three years after firms are declared ST; otherwise, it is a failed CEO replacement. Results show that ST firms undergo frequent CEO turnover. Furthermore, on average, CEO replacement is successful because ST firms function normally when the new CEOs take over the job. The effect of replacement is stronger for state-owned enterprises than non-state-owned ones.

Key words: Distressed firms, ST firms, CEO turnover, state-owned enterprises

JEL: G30; M12

1. Introduction

The recovery of distressed firms from difficulties has gained significant attention. Distressed firms commonly take various actions to rescue the company. Gilson (1989) shows that most distressed firms replace their top managers to survive. Whitney (1987) documents that managers of distressed firms typically change their auditor to bring fresh perspectives. Reducing the number of employees to reduce costs is also a strategy often adopted by distressed firms. DeAngelo (1990) documents that 67% of firms that experience three consecutive years of loss cut dividends in their first year of distress. Moreover, distressed firms may also sell assets or re-organize debt structure to survive.