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CEO career concerns and investment efficiency: Evidence from China

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ABSTRACT

This paper investigates the impact of CEO career concerns on a firm's investment efficiency for publicly listed Chinese companies from 2002 to 2009. We use CEO age and appointment of new CEO as proxies for CEO career concerns. For the whole sample, we demonstrate that younger CEOs and newly appointed CEOs are prone to invest less and more efficiently. We divide our sample into state-owned enterprises and non-state-owned enterprises, depending on their ultimate ownership. The age effect seems stronger in state-owned enterprises and the new appointment effect seems stronger in non-state-owned enterprises. Our results indicate that CEOs have long-term career concerns that can improve a firm's investment efficiency even in a transitional economy such as China.

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1. Introduction

A CEO's career concerns have been the subject matter of great interest to many. First, in a standard principal–agent model, boards supervise CEOs. Here, CEOs have to maximize shareholders' value because their own pay and incentives are set to align managerial interests with shareholders (Beyer et al., 2014; Core et al., 2003; Jensen and Murphy, 1990; Misangyi and Acharya, 2014). Second, the labor market approach indicates that CEOs care about their reputation, because their current performance is related to future employment opportunities in those labor markets (Bizjak et al., 2008; Brickley et al, 1999; Fama, 1980; Liu, 2014; Oyer, 2004). Third, tournament incentives also create a competitive environment and encourage the CEOs to get a higher position and become irreplaceable (Agrawal et al., 2006; Lazear and Rosen, 1981; Marinovic, 2015; Waldman, 2013).

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Because of career concerns, CEOs have a strong incentive to affect their firms' operating decisions to boost overall performance. In this paper, we focus on firms' investment decisions. Theoretical research has been exploring the relationship between CEO career concerns and investment decisions for a long time (Bebchuk and Stole, 1993; Hirshleifer and Thakor, 1992; Holmstrom, 1999; Narayanan, 1985; Prendergast and Stole, 1996; Zwiebel, 1995). However, related empirical results are very limited. The empirical analyses use CEO age as the proxy for career concerns. Young CEOs have a longer career path and more concerns about their future prospects. Recently, Yim (2013) demonstrates that younger CEOs are more likely to announce an acquisition. Li et al. (2014) established that younger CEOs are more likely to open new lines of business and close other existing businesses. Serfling (2014) shows that older CEOs reduce a firm's risk by choosing less risky investment policies. Zhang et al. (2015) also find that younger CEOs in U.K. firms are more likely to acquire a firm outside their main line of business. These studies, however, focus on some specific items related to a firm's investment decisions and do not show whether the efficiency of total investment of the firm is affected by CEO career concerns.

Investment efficiency is an important issue in corporate finance. It is expected to allocate financial resources of a firm to its most profitable projects. However, various frictions and forces may affect a firm's investment efficiency. Young or newly appointed CEOs with less work experience which can be signals of their competence would prefer short-term profits, by hurting their firm's investment efficiency, which is ultimately a long-term operating objective. On the other hand, young or newly appointed CEOs with longer career paths tend to consider their long-term profits and invest more efficiently. Older or long-tenured CEOs may invest less efficiently because of other concerns such as empire building or human capital diversification rather than career concerns, as their work experience serves as a buffer for their mistakes. Therefore, the relationship between CEO career concerns and investment efficiency of firms remains unclear.

This paper examines the relationship between CEO career concerns and a firm's investment efficiency using the data of publicly listed Chinese companies. The most empirical studies in corporate finance are concerned with publicly listed U.S. companies. However, China, which is experiencing a transition from a planned economy to a market economy, presents an interesting scenario. First, the labor market for professional managers is not as well developed in China as it is in U.S. Second, CEOs in state-owned enterprises (SOEs) are nominated by the government of the corresponding level and have to achieve their political and social objectives as well (Chen et al., 2011b; Kato and Long, 2006). Non-SOEs are always controlled by the founding family and many CEOs are founders, their heirs or close relatives (Chen et al., 2011a). Therefore, Chinese CEOs have different incentives from their U.S. counterparts. The different types of incentives present the following questions: Do CEO career concerns exist, and do younger or newly appointed CEOs improve or worsen a firm's investment efficiency in publicly listed Chinese companies?

We divide our sample into SOEs and non-SOEs, depending on their ultimate ownership. For the whole sample, we show that younger CEOs and newly appointed CEOs are prone to invest less and more efficiently. However, on analyzing the separate sub-samples, the age effect seems to be stronger in SOEs, and the new appointment effect, in non-SOEs.

This paper makes the following contributions. First, our results add some new evidence to the limited empirical literature on the relationship between managerial career concerns and firms' investment decisions. Second, this paper enriches the growing research on the relationship between CEO characteristics and corporate decisions: e.g., CEO overconfidence and corporate investment (Malmendier and Tate, 2005), CEO overconfidence and corporate financial policies (Malmendier et al., 2011), CEO personal leverage and corporate leverage (Cronqvist et al., 2012), CEO age and corporate investment policies (Li et al., 2014; Serfling, 2014; Yim, 2013; Zhang et al., 2015). Third, our findings show some evidence that managerial long-term career concerns have positive impacts on investment efficiency even in transitional economies such as China where CEO nomination mechanisms are very different and CEOs have operating objectives other than maximizing stockholder value.

The remainder of this paper proceeds as follows. Section 2 reviews the related literature and develops our hypotheses. Section 3 describes the sample selection, data sources, and sample characteristics. Section 4 presents our empirical findings. Section 5 concludes the paper.

2. Review of literature and development of hypotheses

Since investors demand short-term profits and managers' future wage is based on their past and current performances which reveal the information about their abilities, the latter have to boost their current

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