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Old captains at the helm: Chairman age and firm performance

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ABSTRACT

This paper examines whether the chairmen of the boards (COBs) impose their life cycles on the firms over which they preside. Using a large sample of unlisted firms, we find a robust negative relation between COB age and firm performance. COBs age much like 'ordinary' people. Their cognitive abilities deteriorate, and they experience significant shifts in motivation. Deteriorating cognitive abilities are the main driver of the performance effect that we observe. The results imply that succession planning problems in unlisted firms are real. Mandatory retirement age clauses cannot solve these problems.

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1. Introduction

Extensive literature in economics, psychology, and sociology documents a negative relation between an individual's age and job performance. On average, older individuals perform more poorly in a broad spectrum of cognitive tasks (see, for example, Verhaeghen and Salthouse, 1997), experience a shift in motivation (see, for example, Ebner et al., 2006), and seem to prefer a quieter life (Bertrand and Mullainathan, 2003; Li et al., 2011). These effects often emerge before the age of 50, evolving progressively as individuals grow older. This paper asks whether aging agents affect firm performance and why that could be the case. Because firms, in principle, can adjust their control structures, one would expect performance to be unrelated to the age of the company's captain.

The data tell a different story. Using a unique dataset from a recent survey of more than 1500 chairmen of the boards (COBs) of unlisted corporations in Switzerland, we document a strong and robust negative relation between COB age and various measures of firm performance. In a linear estimation, the numbers indicate that an increase in COB age of one standard deviation (9.6 years) is associated with a drop in return on assets of 0.8% points. This corresponds to a performance decline of approximately 10% for the average firm. Non-parametric regressions reveal that the deleterious effect of COB aging starts at approximately age 50 and bottoms out at approximately age 65—Switzerland's official retirement age. Therefore, it appears that underperforming COBs use the official retirement age as a face-saving exit option.

To the best of our knowledge, we are the first to document a COB age effect in unlisted firms. This finding should contribute to the literature that asks whether individual managers matter for firm performance (see, for example, Bertrand and Schoar, 2003). It also corroborates the view that COBs are among the most prominent players in a corporation (Parker, 1990; Mace, 1986). It is their responsibility to establish and secure effective corporate governance (Florou, 2005) and to make sure that the board fulfills its central duties. According to the Swiss Code of Obligation (§716a), the board's non-transferable and inalienable duties include, among other things, the overall management of the company, the appointment and dismissal of management, and the monitoring of management. A growing body of literature on CEO-COB duality argues that the COB has important monitoring functions (Yermack, 1996; Dahya et al., 2002). Such internal monitoring would seem particularly relevant for unlisted firms because they often lack external mechanisms that could act as substitutes (Booth et al., 2002; Kim and Lu, 2011) and have no liquid stock market that allows (minority) shareholders to walk away.

The puzzling question is why COBs overstay. Several tests indicate that the answer to this question is related to the relatively

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weak corporate governance standards of unlisted firms (see also Loderer and Waelchli, 2010). When we replicate our analysis for a comparison sample of listed Swiss firms, we find profitability to be unrelated to the individual age of the COB (and other top managers). This finding is consistent with previous studies for listed firms in the US (see, for example, Bhagat et al., 2010). Therefore, our results seem to apply to unlisted firms and not to firms at large. Corporate governance also plays an important role within the sample of unlisted firms. For example, we find the COB age effect to be stronger for firms with a more dispersed ownership structure, possibly because collective action problems among shareholders make it more difficult to monitor the monitor (Brickley et al., 1997).

Previous literature shows that the more extensive experience of older individuals can at least partially counteract the deleterious effects of aging (see, among others, Korniotis and Kumar, 2011). This finding is also true for our sample. However, the combined effect of age and experience is still negative and significant.

In addition to experience, a factor that we control for throughout the investigation, Salthouse (2012) argues that an individual's cognitive abilities ('can do') and motivation ('will do') are the two main age-related determinants of job performance. Our unique dataset allows us to construct various measures of these determinants of job performance and to inquire into their relevance. Consistent with the extant literature, we find that cognitive abilities decline with age: older COBs perform significantly worse on a simple speed measure—the time it takes to fill in the questionnaire (see, among others, Park and Reuter-Lorenz, 2009)—and they are more likely to concede that job complexity has increased. Also the 'will do' function seems to deteriorate with age. We find that (1) older COBs are less likely to focus on shareholder value maximization; (2) older COBs prefer 'bureaucratic' activities over strategic tasks; and (3) older COBs are less appreciative of performance-sensitive compensation. This evidence is broadly consistent with the typical patterns of older individuals as documented in the extant literature.

We ask whether the age-related changes in abilities and motivation that we observe explain why performance slows as COBs grow older. We show that the COB age effect is mainly driven by deteriorating cognitive abilities. In particular, profitability is significantly lower in firms with 'slow' COBs (that is, COBs who perform poorly on our speed measure) than in firms with 'quick' COBs. We also find motivational factors to be important, albeit to a lesser extent. Accordingly, COBs who state a commitment to shareholder value maximization are associated with slightly better firm profitability. Together, these two factors are able to fully explain the COB age effect.

To the best of our knowledge, our study is the first to identify the channels through which COB age and firm performance are related. This finding should add to the literature in at least two ways. First, knowing that 'age' essentially reflects cognitive abilities at the corporate helm contributes to a better understanding of the existing findings in the literature, for example with respect to age-related differences in investment (Korniotis and Kumar, 2011) and acquisition (Yim, 2010) behavior. Second, it is important to understand the sources of the age effect before trying to find a possible remedy. Stricter monitoring and more performance-sensitive compensation do not cure cognitive aging. A more promising way to prevent ossification at the helm could be the reallocation of tasks and responsibilities inside the firm and, of course, effective succession planning.

In the last step of the investigation, we ask whether mandatory retirement age limits prevent directors from overstaying, as stipulated by various corporate governance standards, including the report of NACD's Blue Ribbon Commission on Director Professionalism in 2005. Our data cast doubt on the effectiveness of mandatory retirement policies to induce a timely succession plan. We find that COB age is actually *higher* in firms with mandatory retirement age limits. Moreover, the presence of an age limit does not affect the relation between COB age and firm performance. This finding suggests that the ongoing debate about board retirement policies should be taken with a grain of salt.

Problems such as small sample size, measurement error, insufficient control variables, and simultaneity concerns often plague studies based on surveys. While we are aware of these concerns, we believe that they do not significantly affect the interpretability of our results. First, our investigation is based on more than 1500 usable questionnaires, more than three times the sample size of recent studies, such as Graham and Harvey (2001) and Brav et al. (2005). Second, the design of the survey should help us to limit the typical sources of measurement error, including satisficing, acquiescence, and social desirability bias (Weisberg, 2005). The following section addresses these issues in detail. We also run Heckman (1979) selection models and find no evidence of non-response bias. Third, the questionnaire itself was quite extensive, which allowed us to collect important control variables such as tenure, firm size, firm age, leverage, and industry, along with information about the firms' ownership structure, board composition, and family affiliation. Finally, we conduct a series of additional tests to address possible concerns about endogeneity. In particular, the results are maintained if we control for the possibility that poorly performing firms are more likely to hire older COBs. Moreover, the results do not seem to reflect the inability of poorly performing firms to attract competent successors because we find the same results in a subsample of relatively large and well-performing firms. We recognize, however, that such tests only provide a response to specific endogeneity concerns. Without a valid instrument for COB age, we are unable to address the problem of endogeneity in general. Therefore, a careful interpretation of our results treats them as correlations instead of causal relations.

The paper proceeds as follows. Section 2 presents our survey in more detail. Section 3 studies the relation between COB age and firm performance. Section 4 asks how cognitive abilities and motivation change as COBs grow older. Section 5 asks whether changes in abilities and motivation help explain the COB age effect. Section 6 concludes.

2. Survey methodology

Our data come from a survey conducted in 2007. The questionnaire of 11 pages contained 38 questions and was written in German and French—Switzerland's two major languages. The survey was divided into five sections to collect information on the following: (1) board composition; (2) board compensation; (3) the COB's demographics, preferences, tasks, and responsibilities; (4) ownership structure; and (5) other firm characteristics such as age, industry, and financial performance.[1] The main advantage of surveys is that they can provide access to valuable information that is commonly unavailable in register data. At the same time, survey-based research is also prone to several biases. According to Weisberg (2005), the three common pitfalls in survey-based research are non-representativeness, measurement error, and survey administration issues. We briefly discuss these issues and describe the countermeasures taken when designing the questionnaire, conducting the survey, and analyzing the data.

2.1. Representativeness: sample selection, survey, and non-response bias

To obtain a representative picture of corporate Switzerland, we begin the sample selection procedure with Dun & Bradstreet's database, which relies on the official Swiss Commercial Register and covers the vast majority of Swiss corporations. Similar to Bro-

[1] A copy of the survey is available from the authors upon request.

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