

Does the Japanese Governance System Enhance Shareholder Wealth? Evidence from the Stock-Price Effects of Top Management Turnover

Jun-Koo Kang

Korea University and University of California-Riverside

Anil Shivdasani

Michigan State University

This article examines the stock-price effects of top management turnover announcements for 432 Japanese corporations from 1985 to 1990. We find that these announcements are associated with significantly positive abnormal returns. The returns are greater when turnover is forced than when turnover represents normal succession. The stock-price effects are also significantly positive when turnover is forced and the successor is appointed from outside the firm. We find that large shareholders play an important role during outside succession. This evidence suggests that the disciplinary decisions of Japanese governance mechanisms are consistent with shareholder wealth maximization.

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Existing literature shows that a variety of mechanisms provide managers of large publicly traded firms in the United States with incentives to maximize shareholder wealth. These include direct equity ownership, incentive-based compensation contracts such as stock-option plans, monitoring by institutional and large shareholders, and other capital market participants, and the board of directors. In addition, poorly performing managers can face discipline through the external market for corporate control in the form of proxy contests and takeovers. While there is debate on the relative importance and economic significance of these various governance mechanisms, evidence on these mechanisms is well documented.¹

In contrast to the United States, takeovers are extremely rare among large firms in Japan. Instead, many firms are organized as part of an industrial group known as a *keiretsu*. Firms in a *keiretsu* typically maintain extensive trading relations with each other and also own substantial equity in other *keiretsu* member firms. Many Japanese firms also rely heavily on one commercial bank as their primary source of capital. In many cases, the bank is also a major stockholder. Sometimes this main bank relation is part of the *keiretsu* network, although firms outside *keiretsu* groups also maintain ties to a main bank. Further, Japanese managers typically own little equity, and it is widely held that the formal board of directors in Japanese firms does not exert much influence over managerial actions.²

Recently there has been considerable attention on the comparison of these governance structures between the two countries and their effects on managerial incentives and firm value. According to some authors,³ the absence of takeovers and outside directors, and the crossholdings among *keiretsu* firms insulate Japanese managers from disciplinary forces and contribute to managerial entrenchment. In a cover story, *Tokyo Business Today* (August 1993) reports, "The [Japanese] board is almost powerless to curb the authority of the CEO." From a different perspective, Kester (1991) argues that the Japanese governance structure provides managers incentives to maximize the value of the nexus of trading and financial contracts between firms, not necessarily shareholder wealth. It is also suggested that Japanese governance mechanisms focus more on measures of long-term per-

¹ Jensen and Warner (1988) and Black (1992) provide a review of this literature.

² For a discussion of the Japanese governance system, see Abegglen and Stalk (1985), Ballon and Tomita (1988), Kaplan (1994), Kester (1986, 1990), Komiya (1989), Nakatani (1984), Prowse (1990, 1994), and Roe (1993).

³ See, for example, Abegglen and Stalk (1985), Nishiyama (1984), Okumura (1993), and Sheard (1991).

formance such as market share than on “short-term” measures such as stock price [Porter (1992)].

In contrast to these views, several researchers suggest that the main bank system in Japan performs an important governance function. Aoki (1990) and Sheard (1989) argue that main banks discipline managers when performance is poor. They suggest that main banks play an instrumental role in corporate governance in “crisis” situations. Consistent with this view, Hoshi et al. (1990) find that main banks help overcome underinvestment problems during financial distress. In addition, Prowse (1994) suggests that even when firms are not financially distressed, main banks and large creditors monitor and influence managers through regular meetings in keiretsu-affiliated firms.

In addition to the main bank system, large shareholders are common in Japan. Prowse (1992) shows that the top five shareholders own over 30% of the typical publicly traded firm’s outstanding shares. According to Demsetz and Lehn (1985), Jensen (1989), and Shleifer and Vishny (1986), such concentrated ownership provides incentives to monitor managers. However, Barclay and Holderness (1989) and Barclay, Holderness, and Pontiff (1993) argue that blockholders are sometimes able to extract private benefits that are unavailable to diffuse stockholders, thereby decreasing the wealth of such investors. Since many Japanese blockholders belong to a keiretsu and maintain substantial business ties with other firms, it is possible that governance decisions by blockholders result in private benefits that are detrimental to the wealth of diffuse shareholders.

In this article, we examine whether disciplinary actions by governance mechanisms increase shareholder wealth in Japanese corporations. We focus on announcements of removals of top executives in Japanese firms.⁴ Since the removal of the top executive is one of the most drastic and visible actions taken by governance mechanisms, an analysis of the stock-price effects around announcements of top management turnover provides an opportunity to examine the effects of disciplinary actions on firm value. This evidence offers the potential to determine whether the actions of Japanese governance mechanisms are consistent with shareholder wealth maximization.

We use a comprehensive sample of 432 announcements of removals of Japanese presidents by publicly traded firms on the Tokyo Stock Exchange from 1985 to 1990. We find that such announcements result in a significantly positive average stock-price reaction of 0.52%. To focus on turnover events that are disciplinary, we examine re-

⁴ The top executive in Japanese companies is the president, who is the equivalent to the CEO in U.S. corporations. Since top Japanese executives rarely hold the title of CEO, the terms CEO and president are sometimes used interchangeably in Japan.

movals that are likely to be forced, based on the subsequent employment status of the departing president. Announcements of forced turnover (where the president is removed from the board) are accompanied by a stock-price reaction of 1.02% on average, whereas announcements of nonforced turnover (where the president remains on the board) elicit a stock-price response of 0.40%. While both these effects are significant, median returns are significant only for forced turnover announcements.

To further examine cases where governance mechanisms play an important disciplinary role, we compare turnover where the incoming president is appointed from outside the firm with internal succession events. We find that the role of large shareholders during outside succession is extremely important. In 84 of 100 outside succession cases, the successor is appointed by a large shareholder of the corporation. In 60 of these cases, the sending company is the firm's largest stockholder. In an additional 11 cases, the sending firm is the second largest shareholder. We find that conditional on turnover, the likelihood of outside succession increases significantly with the ownership by the firm's corporate blockholders. Consistent with the importance of large shareholders during outside succession, we find that announcement day returns are 1.70% on average and are significantly positive when the successor is appointed from the outside and turnover is forced. Further, the returns for this type of turnover are appreciably higher than other types of turnover.

The stock-price reaction will be the sum of two components: the effect of turnover on underlying firm value and any information revealed by the turnover announcement. If governance mechanisms remove presidents when their information indicates that performance is poor, the turnover announcement will contain an adverse revelation effect. Since the effect of this information revelation is to lower the observed stock-price reaction, the positive announcement returns documented here suggest that removal of top executives increases underlying firm value, particularly when governance mechanisms have been active. Thus, our evidence suggests that the disciplinary decisions by Japanese governance mechanisms enhance shareholder wealth.

The direct involvement of large shareholders during outside succession also provides an opportunity to examine whether outside succession is used to obtain private benefits associated with the control of the appointing firm. We find that the announcement returns for the appointing firm are unrelated to the ownership by the sending blockholder, implying that, at least during outside succession, blockholders do not obtain private control benefits that are unavailable to other shareholders.

This article is organized as follows. In Section 1 we briefly discuss the related literature. Section 2 describes the data. Stock-price reactions to turnover announcements are presented in Section 3. In Section 4 we conduct a cross-sectional analysis of announcement day returns. Section 5 concludes.

1. Related Literature

Our article complements and extends recent work by Kaplan (1994) who presents evidence on the role of the Japanese governance system. Kaplan (1994) examines how top management turnover and compensation changes are related to firm performance for 119 Japanese firms in the Fortune International 500 from 1980 to 1988. He finds turnover among presidents and directors, and compensation changes for directors, are negatively and significantly related to several measures of firm performance, including stock returns. He also finds an increased frequency of bank appointments to the board when performance is poor. Kaplan (1994) concludes that the Japanese governance system provides managers with incentives to care about shareholder wealth.

Additional evidence is provided by Kang and Shivdasani (1995) who find that the probability of forced president turnover increases with poor firm performance. Using a sample of 270 Japanese firms in *Moody's International Reports* from 1985 to 1990, they document that the sensitivity of turnover to performance is higher for firms with ties to a main bank. In addition, firms with main bank ties and high blockholder ownership are more likely to hire a successor from outside the firm. They interpret these results as evidence that banks and large shareholders perform an important monitoring role.

In related work, Morck and Nakamura (1994) find that the likelihood of outside director appointments to Japanese boards increases with poor firm performance. Similar results are obtained by Kaplan and Minton (1994), who also document an increased frequency of management turnover surrounding such appointments and argue that these directors perform an important disciplinary function. While all of the above studies provide evidence that governance mechanisms in Japan are likely to perform a disciplinary role when firm performance deteriorates, the valuation effects of such disciplinary actions remains unexplored.

Some evidence on the role of ownership structure in Japan is provided by Lichtenberg and Pushner (1994). They find that firm performance is positively correlated with ownership by financial institutions, but is negatively correlated with ownership by corporations. They suggest that high levels of corporate ownership "insulate the firm from

outside interference, but at the expense of profit." In this article we provide direct evidence on the influence of corporate and financial investors during the process of top management turnover and of their effects on shareholder wealth.

Our article is also related to the theoretical literature on top management turnover. Hirshleifer and Thakor (1994) develop a model where the board of directors aggregate their own information about managerial performance with that of potential bidders. They suggest that takeover attempts reveal bidders' adverse information about target managerial performance, which is used by the target's board in deciding whether to fire or retain managers. Thus, in their analysis, the information aggregation process during takeovers improves the board's ability to evaluate managerial performance. Since takeovers are infrequent among large Japanese firms, Japanese boards cannot rely upon the information aggregation that occurs during takeovers. However, the presence of main bank ties, large shareholders, and keiretsu linkages can provide alternative mechanisms for the collection and evaluation of information about managerial performance [Prowse (1990, 1994), Sheard (1989)]. Thus, examining the stock-price effects of top executive turnover in Japan provides an opportunity to examine whether turnover decisions resulting from such alternative information acquisition processes are also value enhancing.

Hirshleifer and Thakor (1994) also postulate that the market's response to management turnover is more likely to be positive when there is more adverse public information about managerial performance and when the ex ante likelihood that the board is ineffective is high. A similar prediction is made by Berkovitch and Israel (1994), who argue that when firm performance is not known with certainty, managerial replacements reveal adverse information about managerial quality and performance. As Warner, Watts, and Wruck (1988) note, the adverse information revelation will lower the observed announcement period returns. Thus, in subsequent tests, we examine whether such an information effect is present in our data and its impact on our results.

Our article is also related to several studies that examine wealth effects for management changes in U.S. corporations. These include Bonnier and Bruner (1989), Denis and Denis (1994), Furtado and Rozeff (1987), Park and Rozeff (1994), Warner, Watts, and Wruck (1988), and Weisbach (1988). In general, these studies suggest that turnover announcements in the United States are, on average, accompanied by small but positive announcement day returns, particularly when the departure appears to be disciplinary. Below we present a comparison of our results to those documented in these articles.

2. Data

The sample of top executive turnover announcements is obtained from daily issues of the *Nihon Keizai Shimbun*, which is equivalent to the *Wall Street Journal* in the United States. For each day from January 1, 1985, to December 31, 1990, we search the “Who’s News” section in daily editions of the *Nihon Keizai Shimbun* for announcements of removals of corporate presidents, chairmen, and CEOs of publicly traded firms. We focus on the first public announcement of the turnover. This procedure yields a sample of 525 announcements. Almost all of the announcements refer to the removal of the president, although in a few instances the article refers to the retirement of a chairman. Because the powers exercised by Japanese presidents are typically equivalent to those of U.S. CEOs, we focus the subsequent analysis on president removals. In unreported tests, we obtain qualitatively identical results when announcements of chairman removals are included in the sample. We exclude financial firms from the sample because of the lack of data on these firms. We search the *F&S International Predicast* and the *Wall Street Journal* index for any contaminating news during the 3 days surrounding the turnover announcement, and delete firms with confounding news during this period. Finally, firms with insufficient stock-return data to compute market model parameters are deleted. Stock-return data is obtained from the Pacific Basic Capital Markets Research Center (PACAP) database. This procedure results in a final sample of 432 observations.

From each newspaper announcement we collect data on the background of the departing president. The announcements also typically indicate the successor with a brief description of his background. We use this background information to collect data on the age and tenure of the successor and the year in which he first joined the firm. The announcements often indicate whether the departing president will become chairman of the board or remain on the board of directors. We also note this information for our subsequent tests. In all cases, we verify the information on turnover, the president’s age and tenure, and his subsequent employment with the firm from various sources including *Yakuin Shikiho*, *Kigyo Keiretsu Soran*, *Kaisha Shokuin Roku*, and *Nihon No Sacho*. In some cases, we find that although the newspaper story indicates that the president will (or may) remain on the board of directors, this in fact is not the case. In these instances, we use the actual status of the president in classifying whether or not the president remains on the board. Our results are unchanged if we use the data contained in the newspaper articles instead.

Summary statistics on the financial structure of our sample firms are reported in panel A of Table 1. For ease of interpretation, values

in Japanese yen are converted to U.S. dollars using the month-end exchange rate at the end of the fiscal year. The average (median) firm in the sample has total assets of \$1,384 (\$405) million and a market value of equity of \$1,767 (\$417) million. Mean (median) sales for our sample are \$2,065 (\$435) million. For comparison, Kaplan's (1994) sample has a mean (median) market value of equity of \$6,638 (\$3,703) million and mean (median) sales of \$5,649 (\$3,456) million in 1988. Thus, our sample firms are considerably smaller than those examined by Kaplan (1994), with median sales approximately eight to nine times lower.

Panel B reports information on corporate governance characteristics. We consider the 10 largest stockholders of the firm to be blockholders. Ownership by blockholders that are financial institutions (financial blockholders) averages 23.6% and that by blockholders that are nonfinancial corporations (corporate blockholders) averages 19%. The mean ownership by the board of directors is 2.8%. To measure the strength of the ties a firm has to a main bank, we use a dummy variable that equals 1 if the firm's largest creditor is also a blockholder in the firm. This definition captures a key feature of the main bank system, where banks are both large creditors and large shareholders. According to this definition, 80% of the firms have ties to a main bank. We also use two alternative measures of main bank ties. First, following Kang (1993), we consider firms to have a main bank if the largest lender is the largest stockholder in the firm. According to this measure, 9% of our firms have a main bank. Second, we follow Hoshi, Kashyap, and Scharfstein (1990) and use the borrowing from the firm's largest creditor as a fraction of total bank debt to measure the strength of the main bank relation. On average, our sample firms borrow 21% of their total bank debt from their largest creditor. Both approaches yield results qualitatively identical to those presented below. Data on ownership structure and bank borrowings is obtained from various issues of *Kigyo Keiretsu Soran*, *Daiwa Analyst's Guide*, and *Yakuin Shikiho*.

We categorize firms as either belonging to a keiretsu or as being independent of corporate groupings. We focus on the six major keiretsus of Mitsubishi, Mitsui, Sumitomo, Fuyo, DKB, and Sanwa. By this definition, 38% of the firms belong to a keiretsu. In unreported tests, we consider two alternative definitions of keiretsu membership. First, we include only those firms that are members of the group's president's council. These firms meet regularly and comprise the core firms in the group. Of our sample firms, 13% belong to a president's council. Second, we consider a broader definition of keiretsu membership that includes other industrial groups of Tokai, IBJ, Nippon Steel, Hitachi, Nissan, Toyota, Matsushita, Toshiba, Tokyu, and Seibu

Table 1
Summary statistics for sample of Japanese firms that announced president turnover in the *Nihon Keizai Shimbun* from 1985 to 1990

Variables	Full sample <i>N</i> = 432	Forced departure <i>N</i> = 96	Unforced departure <i>N</i> = 336	Outside succession <i>N</i> = 104	Inside succession <i>N</i> = 328
	Mean (median)	Mean (median)	Mean (median)	Mean (median)	Mean (median)
Panel A: Financial structure variables					
Market value of equity (\$ million)	1767 (417)	628 (353)	2096 (429)**	653 (232)	2125 (509)***
Total assets (\$ million)	1384 (405)	694 (359)	1581*** (415)	642 (268)	1619*** (429)***
Sales (\$ million)	2065 (435)	726 (435)	2448*** (434)	909 (346)	2432** (484)***
Total liabilities/total assets	0.65 (0.66)	0.68 (0.68)	0.64* (0.65)*	0.69 (0.72)	0.63*** (0.65)***
Bank loans/total assets	0.21 (0.17)	0.22 (0.17)	0.21 (0.17)	0.24 (0.20)	0.20* (0.16)*
Panel B: Governance variables					
Ownership by financial blockholders (%)	23.55 (23.47)	23.18 (22.46)	23.66 (23.56)	20.11 (19.45)	24.64*** (25.03)***
Ownership by corporate blockholders (%)	18.96 (10.11)	22.72 (16.23)	17.89** (9.33)**	32.00 (38.19)	14.84*** (7.00)***
Ownership by board of directors (%)	2.80 (0.5)	2.23 (0.4)	2.96 (0.5)	1.26 (0.3)	3.29*** (0.6)***
Percentage of firms with main bank	79.67 (n.a.)	78.95 (n.a.)	79.88 (n.a.)	77.67 (n.a.)	80.31 (n.a.)
Percentage of keiretsu firms	37.50 (n.a.)	27.08 (n.a.)	40.48** (n.a.)	40.38 (n.a.)	36.59*** (n.a.)
Number of directors	19.26 (18)	17.92 (17)	19.65*** (18)**	16.96 (17)	20.00*** (18)**
Number of outside directors	3.38 (3)	4.02 (4)	3.20** (3)**	5.62 (5)	2.67*** (2)***
Number of bank directors	0.69 (0)	0.74 (0)	0.68 (0)	0.82 (0)	0.65 (0)
Number of corporate directors	2.69 (2)	3.28 (2)	2.52** (2)**	4.81 (5)	2.02*** (1)***
Number of directors concurrently employed by another organization	0.92 (0)	0.99 (0)	0.89 (0)	1.44 (1)	0.75*** (0)***

Saisan. Using both approaches, we obtain results similar to those presented in this article. Data on keiretsu membership is obtained from Industrial Groupings in Japan (1985).

Table 1 continued

	Full sample <i>N</i> = 432	Forced departure <i>N</i> = 96	Unforced departure <i>N</i> = 336	Outside succession <i>N</i> = 104	Inside succession <i>N</i> = 328
Variables	Mean (median)	Mean (median)	Mean (median)	Mean (median)	Mean (median)
Panel C: Performance variables					
Market-adjusted stock return (%)	-3.19 (-11.97)	-5.13 (-13.90)	-2.63 (-11.94)	-6.04 (-14.05)	-2.28 (-11.42)
Industry-adjusted stock return (%)	6.02 (-2.40)	1.62 (-5.04)	7.27 (-1.62)	2.41 (-7.58)	7.16 (-1.25)*
Industry stock return (%)	13.90 (11.81)	17.16 (13.79)	13.05* (11.32)*	14.33 (11.75)	13.85 (11.81)
Percentage of firms with negative industry stock return	21.53 (n.a.)	18.75 (n.a.)	22.32 (n.a.)	23.08 (n.a.)	21.04 (n.a.)
Industry-adjusted ROA (%)	-0.10 (-0.20)	-1.18 (-0.50)	0.21** (-0.06)*	-0.83 (-0.62)	0.13* (-0.06)
Percentage of firms with negative earnings	6.71 (n.a.)	12.50 (n.a.)	5.06** (n.a.)	13.46 (n.a.)	4.57** (n.a.)
Panel D: Turnover-specific variables					
Forced turnover (%)	22.22 (n.a.)	n.a. (n.a.)	n.a. (n.a.)	37.50 (n.a.)	17.38*** (n.a.)
Age of removed president	67.50 (67)	66.36 (67)	67.84** (67)	66.46 (67)	67.84** (68)**
Tenure of removed president	9.86 (6)	7.07 (5)	10.65*** (7)***	5.99 (5)	11.07*** (7)**
Age of new president	58.44 (60)	58.78 (60)	58.35 (60)	61 (61)	57.63*** (59)***
Number of years new president has been with firm	22.15 (27)	15.97 (9)	23.82*** (30)***	0.94 (1)	28.44*** (33)***

Turnover is considered to be forced if the president does not remain on the board of directors. Turnover is considered to be unforced if the president remains on the board of directors. Appointments are considered to be from the outside if the new president joined the firm within the last 3 years from another organization. ***, **, *, indicate that a *t* test for differences in means is significant at the 1%, 5%, and 10% level, respectively. Asterisks next to parentheses indicate corresponding significance levels from a Wilcoxon test. Asterisks in the unforced departure column indicate differences between forced and unforced departures. Asterisks in the inside succession column indicate differences between outside succession and inside succession.

To examine the presence of outside directors, we follow Aoki, Patrick, and Sheard (1994), Kaplan and Minton (1994), and Sheard (1994). Aoki et al. argue that Japanese boards consist of two types of directors: inside directors that have typically been lifelong employees of the firm, and outside directors, who are former employees of other organizations and have typically joined the firm as a corporate director. Accordingly, we consider directors with previous experience at

other organizations to be outside directors. Auditors, who are generally nonvoting members of the board, are not considered to be outside directors. In addition, retired government officials and non-Japanese directors are also not considered to be outside directors. Our treatment of auditors, government officials, and non-Japanese directors follows that of Kaplan and Minton (1994). Our results are unchanged if such directors are considered to be outsiders.

The mean (median) board size is 19.26 (18) directors, of which 3.38 (3.0) are outsiders. In comparison, Kaplan and Minton (1994) report that the median number of outside directors in their sample is two. Thus, outside directors are represented with a higher frequency in our sample. The majority of outside directors in our sample come from other corporations. The median number of corporate outside directors is two, while the median firm has no bank directors. On average, 19.5% of the board consists of outside directors. For comparison, Sheard (1994) reports that among all publicly traded firms in Japan during 1991, the average fraction of outside directors is 21.8%. Our data also confirm that directors holding concurrent appointments in other firms (as outside directors usually do in the United States) are infrequent in Japan. The average number of such outside directors is 0.92, with the median firm having no such directors.

We recognize a potential drawback of our measure of outside directors, which includes all directors with prior outside experience, irrespective of how long they have been a director of the firm. Kaplan (1994) finds that on average only 1.38 directors joined the board within the prior 7 years for firms in his sample. Thus, some directors that we classify as outsiders may have been on the board for several years, and should therefore more appropriately be considered as insiders. However, lacking complete data on the dates all outside directors joined our sample boards, we are precluded from conducting a finer distinction.

Consistent with Kaplan (1994), panel C shows that our sample firms perform poorly prior to turnover. The market-adjusted return, computed as the stock return less the return on the PACAP equally weighted index, from days -220 to -20 relative to the announcement is consistently negative. We also compute industry and industry-adjusted stock returns over this interval using the Tokyo Stock Price Index for each industry. The poor performance appears to stem from underperforming the industry, rather than poor industry-wide performance. The median industry-adjusted stock return is negative, while only 22% of the firms are in industries with negative stock returns over this period. Thus, the majority of turnover does not appear to be concentrated in poorly performing industries. This evidence is consistent with Morck, Shleifer, and Vishny (1989), who find that U.S.

CEO turnover is concentrated in firms that underperform the industry but are otherwise in healthy industries. A similar effect for president turnover in Japan is also documented by Kang and Shivdasani (1995).

Panel D of Table 1 summarizes the nature of the turnover in the sample. The median age of the removed president is 67 years, and the median tenure is 6 years. In 22.2% of the cases, the president is removed from the board of directors. The median age and tenure of our sample presidents are roughly comparable to those in Kaplan (1994), who reports corresponding values of 68 and 5.3 years, respectively. However, while Kaplan finds that 4.8% of the presidents are no longer on the board, the corresponding rate is much higher in our sample. In addition to differences in the nature of departures, the two samples also appear to differ in the nature of incoming presidents. While the new president has been with the firm for a median of 27 years in our sample, the corresponding number in Kaplan is 39 years. There are two possible explanations for this difference. First, Kaplan's sample consists of larger firms, and it is likely that it takes longer to become president via internal promotions in larger organizations. Second, as we discuss below, our sample consists of a relatively high frequency of presidents who are hired from other firms and thus have not been employed by the current firm for long.

Since our objective is to evaluate the wealth effects of disciplinary actions by governance mechanisms, we classify our sample into turnover events that are likely to be disciplinary and those that are likely to represent normal succession. Because disciplinary turnover events are more likely to represent cases where governance mechanisms have performed an active role, focusing on these events will permit more precise tests of the effects of governance mechanisms. We follow Kang and Shivdasani (1995), classifying turnover events where the president remains on the board as normal succession and those where the president is no longer on the board as forced departures. This procedure will undoubtedly result in some classification error. For example, the president may remain on the board following a disciplinary removal in some instances. Alternatively, some managers could choose to retire by stepping down from both the presidency and the board of directors. Nonetheless, we expect some distinction between forced departures and normal retirements to permit more powerful tests.⁵

According to the above definition, 22.22% of the turnover events are classified as forced departures. To examine whether these events

⁵ In unreported tests we also experiment with an alternative measure of forced departures, defining it to also include cases where the president remains on the board, but not as the chairman. We obtain similar results with this approach, although the coefficients are not estimated as precisely.

are indeed likely to be disciplinary, we compare these departures with the previous instance of turnover for our sample firms. If our classification is accurate, we would expect that events categorized as forced departures are more likely to differ from the previous instance of turnover experienced by the firm than events we consider to be normal retirements. For 226 firms we are able to determine whether, during the previous instance of turnover, the president remained on the board or not. For 58 of the 226 firms, turnover of the current president is classified as forced. For 38 (65.5%) of these 58 firms, turnover of the prior president was not forced. In contrast, for the 168 of the 226 firms where the current turnover is not forced, turnover of the previous president was forced in 39 (23.2%) cases. Thus, our classification scheme implies a substantially higher frequency of instances where the current turnover differs from the turnover of the previous president during events we classify as forced turnover than in the cases where we consider departure to be normal.

An alternative way to address this issue is to compare the tenure of removed presidents in our sample to the tenure of the firm's prior presidents. Kaplan (1994) suggests that Japanese presidential tenure has a "conveyor belt" property, and that it may be normal for presidents to resign at regular intervals regardless of firm performance. If this description is accurate, a large part of Japanese presidential tenure may be determined by custom. Thus, by examining whether the tenure of removed presidents in our sample is less than the historical average for these firms, it is possible to judge whether current presidents depart "early" by customary standards.

In order to estimate the customary tenure of presidents in our sample firms, we collect data on the tenure of the previous five presidents for each of our sample firms. In some instances, however, we are able to obtain the tenure data for fewer than the previous five presidents for two reasons. First, we were only able to obtain data on the identity of presidents in office after 1945,⁶ or the year of incorporation (whichever is later). Second, some firms have fewer than five prior presidents since incorporation. We are able to obtain data on prior president tenures for 382 firms in the sample. For these firms, the mean (median) prior presidential tenure is 10.63 (8.26) years, which is slightly higher than the tenures of the removed presidents in our sample. We use the ratio of current president tenure to the historical average to identify departures that are early by historical standards. For the full sample, this ratio has a mean (median) of 1.21 (0.8). How-

⁶ In most cases, we are able to determine the starting date of presidents if they were in office as of 1945. Data on prior presidential tenure is obtained from various issues of the *Japan Company Handbook*, *J. B. Diamond's Directory*, *Kaisha Shikibo*, *Yakuin Shikibo*, and *Kaisha Rireki Soran*.

ever, for the forced turnover subsample, the mean (median) ratio is 0.86 (0.54) compared to 1.31 (0.85) for the unforced subsample. This difference is significant at the 5% level. Using a ratio value less than one to classify “early” departures identifies 75% of the forced turnovers as early departures, compared to 61% of the unforced turnovers. Thus, our definition of forced turnover appears to capture a greater fraction of removals that are early by customary standards. Nonetheless, a high fraction of unforced removals also appear to depart early, suggesting that the forced classification may not capture all of the disciplinary turnover. Thus, in the subsequent tests, we supplement the forced/unforced distinction with the early departure variable.

We also investigate the backgrounds of the incoming presidents. The median age of the new president is 60 years. In 173 cases, the successor has experience with another organization prior to joining the sample firm. However, unlike the data for outside directors, we are able to determine when the new president joined the firm for all observations in our sample. In 52 cases, the successor joined the firm in the year of turnover. In an additional 52 cases, the successor entered the firm within 3 years prior to turnover. Thirty presidents entered the firm 4 to 10 years prior to becoming president, while an additional 20 entered the firm 11 to 20 years before. Finally, the remaining 19 presidents joined the firm more than 20 years before becoming president.

Recognizing that it is more appropriate to consider presidents who have been with the firm for a substantial length of time as insiders, we classify the 104 presidents with prior outside experience who joined the firm within the last 3 years as outside appointments. We expect that these executives were likely hired with the intention of being promoted to president, as it appears unlikely that their performance within the firm during this short period would warrant promotion to the top. Our definition of outside succession is similar to that used by Parrino (1992) for U.S. data, and by Kang and Shivdasani (1995) for Japanese data. Nonetheless, it is possible that presidents who have prior experience at other organizations and have been with the firm for more than 3 years differ from presidents who are lifetime employees. Thus, we term presidents with prior outside experience who have been with the firm for more than 3 years as “quasi-inside” appointments, and separately examine the effects of such succession on shareholder wealth.

We investigate the extent to which outside appointments represent a departure from normal succession practices. For 130 firms, we are able to determine the status of both the succeeding president and the departing president. For 66 of these firms, the current successor is an outside appointment. In 54 (82%) of these cases, the departing

president was also an outside appointment. In contrast, for the 64 firms where the current successor is an insider, only 11 (17.2%) firms appointed an outsider during the previous turnover. Thus, firms that hired outside presidents during the previous turnover are more likely to hire an outsider during the current turnover.

The 24.1% frequency of outside succession in our sample is considerably higher than in Kang and Shivdasani (1995), who document an outside succession frequency of 10.3% among Japanese firms in *Moody's International Manuals*. One potential explanation for this difference is that *Moody's* covers only the largest firms in Japan, and that outside succession is less likely for large firms. We investigate this possibility in more detail below. Interestingly, the frequency of outside appointments in our sample is comparable to the 20.3% frequency for large U.S. corporations documented by Parrino (1992). The likelihood that the president will be removed from the board is higher when succession is from the outside. This happens in 37.5% of the cases, compared to a 17.4% frequency when the successor is hired from within the firm.

Table 1 also indicates that several characteristics vary across the type of turnover. Firms experiencing forced departures tend to be smaller, have greater ownership by corporate blockholders, have more outside directors, and are less likely to be part of a keiretsu compared to firms where turnover is not forced. Firms that hire outside presidents are also smaller, have greater corporate block ownership, and have more outside directors than firms that hire internally. In addition, ownership by financial blockholders and the board is lower for firms experiencing outside succession.

From each announcement we also collect the stated reasons for turnover. Examining the stated reasons provides another means to judge which cases represent disciplinary events. A potential drawback of using the stated reasons is that firms may sometimes attempt to disguise the true motivation underlying the turnover. For example, Denis and Denis (1994), Warner, Watts, and Wruck (1988), and Weisbach (1988) find that U.S. corporations rarely state the true reason for turnover. Our procedure for classifying the reasons parallels that by Warner, Watts, and Wruck (1988).

Table 2 shows that of the articles we classify as indicating a disciplinary reason, poor firm performance is mentioned in six cases, poor industry performance in one case, and five cases identify the need for new management with certain required skills. We also interpret two cases where corporate restructuring is mentioned as the reason for change as a disciplinary motivation. One firm specifically blames the outgoing president for his failure in developing a new product. In three announcements the article mentions that the firm is developing

Table 2
Stated reasons for president change for sample of Japanese firms that announced turnover in the *Nihon Keizai Shinbun* from 1985 to 1990

Stated reasons	President remains on the board	President not on the board	Total
<i>Disciplinary:</i>			
Need for younger management	28	7	35
Poor company performance	2	4	6
Corporate restructuring	2	0	2
Need for new management with required skills	5	0	5
Poor industry performance	1	0	1
Stronger ties with main banks or other companies	2	1	3
Take job in another firm	1	1	2
Failure to develop a product	1	0	1
Subtotal	42	13	55
<i>Nondisciplinary:</i>			
Death	0	14	14
Poor health or illness	12	10	22
Old age or retirement age	70	18	88
Anniversary of company	12	1	13
Company stabilized or performing well	24	4	28
Long tenure	9	1	10
Listing in upper section of stock exchange	1	0	1
Subtotal	128	48	176
<i>Other:</i>			
No reason given	165	34	199
Merger	1	1	2
Subtotal	166	35	201
Total	336	96	432

closer links to its main bank or a large shareholder. Since this is likely to indicate the intervention of governance mechanisms, we also interpret this as a disciplinary motivation. In 35 cases, a need for younger management is mentioned. This procedure results in 55 announcements for which we consider the stated reason to be disciplinary.

Of the reasons in the normal succession category, 14 cases involve the death of the president. In some of these cases, the announcements refer to a previously announced death and simply provide details on the successor. For this reason, we exclude them from the subsequent analysis. Old age, or the reaching of retirement age, is the most common reason stated in the newspaper stories, and is mentioned in 88 cases. In an additional 22 cases, poor health or illness is mentioned as the reason for change. In 10 instances the article makes a reference to the long tenure of the outgoing president. In 28 articles, good performance or the stabilization of firm performance is mentioned. We

interpret these articles as indicating normal succession. In 13 cases the article quotes the outgoing president as saying that since an important company anniversary has been reached, this seems to be a “good time to step down.” We also interpret these to indicate normal succession. By this process, 176 announcements are classified as normal succession.

No reason for turnover is mentioned in 199 cases. It is not obvious whether these are disciplinary events or not, therefore we classify them in a residual category. However, the failure to provide a reason could be an implicit acknowledgment that turnover was motivated by disciplinary considerations. Accordingly, we also report results where such announcements are considered disciplinary events in the subsequent tests. Finally, in two cases, the announcements state that turnover is due to a merger. It is unclear whether these cases represent disciplinary turnover or normal succession. Therefore, we also classify these observations in the residual category. Our results are unchanged if we classify them as disciplinary or normal events.

This analysis of the reported reasons suggests that Japanese firms rarely state the true motivation underlying the turnover. For example, despite the poor performance of the sample firms, and the fact that 22% of the presidents are no longer on the board, some aspect of poor performance is mentioned in only seven cases. In addition, 199 firms (46%) provide no reason. Further, in one case (Mazda Motor Corp.), we find subsequent newspaper coverage indicating that poor performance is the reason for the turnover, even though the company officially stated poor health (*Japan Economic Times*, January 23, 1988, p. 5).

3. Empirical Results

3.1 Announcement effects

We use standard event-study methodology to compute announcement period returns. Market model parameters are estimated using returns from days -220 to -20 , where day 0 denotes the announcement date. Table 3 reports the cumulative abnormal return (CAR) for the removal announcements, for 2- and 3-day windows. For the full sample, the mean CAR $(-1, 0)$ is 0.52% and the mean CAR $(-1, +1)$ is 0.65%, both of which are significant at the 1% level. In addition, the median CAR $(-1, 0)$ is 0.09% and is significant at the 5% level. In the next two rows we stratify the sample according to whether the president remains on the board of directors or not. The average CAR $(-1, 0)$ for removals where the president is no longer on board is 1.02%, compared to 0.40% when the president remains on the board. Both effects are statistically significant at the 5% level. However, inspec-

tion of medians indicates that when the president is no longer on the board, the median return for the $(-1, 0)$ interval is 0.15% and for the $(-1, +1)$ interval is 0.20%. These are statistically significant at the 5% and 10% level, respectively. In contrast, the corresponding median returns when the president remains on the board are 0.07% and -0.06%, respectively, and are not statistically significant.

As discussed above, classifying turnover by the subsequent employment status of the president may be subject to classification error. To apply an additional screen to the data, we further divide the sample according to both the subsequent employment of the president and the stated reasons in the announcement. For the 13 cases where the president is no longer on the board and the announcement also indicates a disciplinary reason, the mean CAR $(-1, 0)$ is 2.24% and the mean CAR $(-1, +1)$ is 2.55%. Median returns for these intervals are 0.14% and 2.84%, respectively. However, only the mean CAR $(-1, +1)$ is significant at the 10% level, probably because of the small number of such announcements. Because announcements where no reason is mentioned could include some instances of disciplinary removals, we also report CARs when turnover is forced and the reason is disciplinary or unreported. The mean CAR $(-1, 0)$ and CAR $(-1, +1)$ are 1.09% and 1.07%, respectively, and are statistically significant. The median CAR $(-1, 0)$ for this category is also positive and marginally significant. While the CARs for forced removals where a nondisciplinary reason is announced are positive, they lack statistical significance. When turnover is not forced, and the reason is disciplinary, both mean and median CARs, while positive, are also statistically insignificant. The 128 firms where the president remains on the board and the stated reason is nondisciplinary show evidence of a positive stock-price response. For these firms, the mean CAR $(-1, +1)$ is 1.15% and statistically significant. This suggests that during normal succession, firm value is enhanced when the president remains on the board. One possible explanation for these results is that, during normal succession, the presence of the outgoing president on the board facilitates a smooth transition, which is viewed positively by stock market participants. Finally, we stratify the sample according to whether or not the departure was early by customary standards. Early departures exhibit significantly positive mean and median returns. In contrast, the announcement returns for nonearly departures are indistinguishable from zero.

A potential problem with these CARs is that top management turnover is a partially anticipated event, and that the probability of turnover varies systematically with the age of top management and firm performance. This raises the possibility that CARs estimated from a market model are biased when firms are performing poorly, or where the

Table 3
Cumulative abnormal returns (CARs) for a sample of Japanese firms that announced president turnover in the *Nihon Keizai Shinbun* from 1985 to 1990

Type of turnover	Days in relation to initial announcement						Two-stage CARs			N
	Market-model CARs			-1 to +1						
	Mean	Median	N	Mean	Median	N	Mean	Median		
Full sample	0.52 (0.00)	0.09 (0.05)	416	0.65 (0.00)	-0.04 (0.07)	416	0.80 (0.01)	0.16 (0.05)	357	-0.05 (0.08)
Unforced turnover	0.40 (0.04)	0.07 (0.26)	335	0.57 (0.02)	-0.06 (0.25)	335	0.61 (0.07)	0.09 (0.34)	285	-0.15 (0.27)
Forced turnover	1.02 (0.01)	0.15 (0.04)	81	1.00 (0.02)	0.20 (0.10)	81	1.54 (0.01)	0.33 (0.02)	72	0.28 (0.10)
Unforced turnover and nondisciplinary reason	0.56 (0.08)	0.09 (0.16)	128	1.15 (0.01)	0.23 (0.03)	128	1.00 (0.13)	0.11 (0.24)	108	0.63 (0.04)
Unforced turnover and disciplinary reason	0.77 (0.13)	0.22 (0.24)	42	0.98 (0.18)	0.17 (0.48)	42	1.42 (0.14)	0.18 (0.30)	28	0.25 (0.40)
Forced turnover and nondisciplinary reason	0.93 (0.15)	0.12 (0.28)	34	0.89 (0.15)	0.07 (0.39)	34	1.23 (0.15)	0.26 (0.24)	31	-0.12 (0.48)
Forced turnover and reason is disciplinary or unreported	1.09 (0.04)	0.47 (0.09)	47	1.07 (0.08)	0.22 (0.21)	47	1.78 (0.03)	1.32 (0.04)	41	0.49 (0.16)
Forced turnover and reason is disciplinary	2.24 (0.14)	0.14 (0.27)	13	2.55 (0.09)	2.84 (0.11)	13	3.69 (0.10)	1.74 (0.18)	12	4.80 (0.08)
Early departures	0.77 (0.00)	0.22 (0.02)	235	0.88 (0.00)	0.16 (0.02)	235	1.03 (0.00)	0.26 (0.03)	199	0.18 (0.05)
Nonearly departures	0.07 (0.82)	0.05 (0.83)	132	0.26 (0.47)	-0.43 (0.87)	132	0.17 (0.75)	0.09 (0.86)	115	-0.60 (0.87)

Market model CARs are computed using days -220 to -20 as the estimation period for market model parameters. Two-stage CARs are computed by weighting the market model CARs by the reciprocal of $(1 - p)$, where p is the estimated probability turnover from the logit model in Section 4.1; p values are in parentheses. Turnover is considered to be forced if the president does not remain on the board. Turnover is considered to be unforced if the president remains on the board. The classification of disciplinary and nondisciplinary reasons is presented in Table 2. Departures are considered to be early if tenure is less than the firm's historical average.

president is close to retirement. We attempt to control for such prior anticipation by estimating the CARs using a two-stage procedure. In the first stage, we estimate the likelihood of turnover for our sample firms. In the second stage, we compute CARs adjusted for the estimated probability of turnover. We compute the adjusted CARs as the market model CAR times $1/(1 - p)$, where p is the estimated probability of turnover. This approach is similar to that used by Bhagat and Jeffries (1991) in the context of antitakeover amendments and by Chaplinsky and Hansen (1993) for debt issues in the United States.

To estimate the probability of turnover, we use the Kang and Shivdasani (1995) turnover data on 270 nonfinancial firms from 1985 to 1990. The following logit model is estimated (p values in parentheses):

$$\begin{aligned} \text{Probability (turnover)} = & -6.08 + 0.07 \text{ (president age)} + 0.003 \text{ (president tenure)} \\ & (0.00) \quad (0.00) \quad (0.79) \\ & - 0.320 \text{ (prior industry-adjusted stock return)} - 0.18 \text{ (industry stock return)} \\ & (0.09) \quad (0.17) \end{aligned}$$

Number of observations = 1325.

We use the estimated probability from the above model to adjust the CARs obtained from the market model regression. Because data on president characteristics is unavailable for some of our sample firms, we are able to compute adjusted CARs for 357 of the sample firms. The average (median) estimated probability of turnover for the sample is 25.9% (24.1%), ranging from a minimum of 5.2% to a maximum of 66.6%.

We recognize a potential problem with the two-stage CARs. To the extent that the turnover prediction model is incorrectly specified, the probabilities will be estimated with error. This introduces error into the two-stage estimates, reducing the precision of the tests. While we have no reason to suspect that the estimates are biased, we experiment with several variants of the above model and obtain results similar to those reported.⁷ Nonetheless, the two-stage CARs need to be interpreted with some caution. These results are only intended as

⁷ Specifically, we estimate the model (i) including measures of firm size and dummy variables for the year of turnover, (ii) using market-adjusted stock returns instead of industry-adjusted returns, (iii) including governance variables, (iv) including interaction variables between firm performance and governance characteristics, (v) using the industry-adjusted return on assets as an accounting-based measure of performance instead of stock returns, and (vi) separately estimating models for forced and unforced departures. We use the forced turnover model to compute the estimated probability of forced departures for our sample firms and use this estimated probability to adjust the CARs for announcements of forced turnover. The probability of routine turnover is used to adjust the observed CARs for routine turnover announcements. While the results are qualitatively similar with all approaches, they are slightly weaker with approach (iv), and stronger with approach (vi).

a check to ensure that the differences in CARs documented above are not driven entirely by differences in the predictability of different types of turnover events.

The estimated CARs from the two-stage procedure are also reported in Table 3. While these adjusted CARs are larger in magnitude than the unadjusted CARs, the overall pattern across the different turnover categories is similar. For the full sample, both the mean and median adjusted CAR $(-1, 0)$ are positive and significant. While the mean adjusted CAR $(-1, +1)$ is also significantly positive, the median CAR $(1, +1)$ is -0.05% and marginally significant. Consistent with the earlier results, adjusted median CARs are not significant when the president remains on the board. However, when turnover is forced, the mean CAR $(-1, 0)$ is 1.54% and the mean CAR $(-1, +1)$ is 1.45% , both of which are significant. Median CARs are also positive and significant for forced turnover. For the subsample when turnover is forced and a disciplinary reason is reported, the mean and median CAR $(-1, +1)$ are 3.97% and 4.80% , respectively, and marginally significant.

3.2 Outside appointments

The decision to remove a poorly performing president also involves the choice of a successor. In particular, an important decision is whether the new president will be promoted from within the firm or hired from outside. In this section we examine whether governance mechanisms play an important role in the choice of successor by influencing the likelihood that the new president is an outside appointment.

We examine three factors in the decision to appoint the successor from outside. First, we examine whether the likelihood of outside succession increases with the importance of governance mechanisms. We measure the effect of governance mechanisms by using the ownership by corporate and financial blockholders, the number of outside directors, and dummy variables for keiretsu and main bank ties. Second, we investigate whether outside succession is more likely when the departure of the outgoing president is forced. Third, we examine whether outside succession likelihood varies with firm size. We expect that larger firms will have a larger pool of suitable internal candidates. If outside succession is more likely when the pool of internal candidates is lacking in managerial talent, we expect the probability of an outside appointment to be lower for large firms. Alternatively, it may be harder to orchestrate an outside succession in larger firms if the influence of governance mechanisms in such firms is weaker.

Table 4 presents logit results where the dependent variable equals 1 if outside succession occurs and 0 if the appointment is internal. These regressions control for the prior industry-adjusted and industry

Table 4
Logit estimates of the probability of an outside appointment for sample of Japanese firms that announced president turnover in the *Nihon Keizai Shimbun* from 1985 to 1990

Explanatory variables	(1)	(2)	(3)
Intercept	2.26 (0.20)	2.43 (0.17)	2.16 (0.22)
log (market value of equity)	-0.44 (0.00)	-0.44 (0.00)	-0.43 (0.00)
Prior industry-adjusted stock return	-0.17 (0.64)	-0.19 (0.59)	-0.11 (0.73)
Prior industry stock return	0.06 (0.94)	0.11 (0.88)	0.16 (0.84)
Main bank	0.09 (0.98)	-0.02 (0.96)	0.02 (0.95)
Keiretsu	0.33 (0.26)	0.27 (0.36)	0.25 (0.40)
Ownership by corporate blockholders	0.02 (0.07)	0.02 (0.04)	0.02 (0.05)
Ownership by financial blockholders	-0.01 (0.79)	-0.00 (0.88)	-0.00 (0.88)
Ownership by directors	-0.06 (0.18)	-0.07 (0.15)	-0.06 (0.17)
Number of outside directors	0.20 (0.00)	0.21 (0.00)	0.20 (0.00)
Forced turnover	0.93 (0.00)		
Forced turnover and reason is disciplinary		1.30 (0.04)	
Forced turnover and reason disciplinary or unreported			0.97 (0.01)
Model p value	0.00	0.00	0.00
Pseudo- R^2	0.24	0.22	0.23
Number of observations	407	407	407

Outside appointments are those where the new president joined the firm in the last 3 years. Stock returns are measured from days -220 to -20 relative to turnover. Main bank is a binary variable that equals 1 if the largest creditor is among the 10 largest shareholders. Turnover is considered to be forced when the president does not remain on the board. The classification of reasons is presented in Table 2. P values are in parentheses.

performance. Three specifications are used that differ in the identification of disciplinary turnover. In specification 1 we include a dummy variable for forced departures. In specification 2 we include a dummy that equals 1 if turnover is forced and a disciplinary reason for the departure is indicated in the announcement. Specification 3 includes a dummy variable that equals 1 if departure is forced and the stated reason for the departure is disciplinary or is unreported.

The coefficient on firm size is negative and statistically significant across all specifications. The role of corporate governance mechanisms during outside succession appears to be very important. The likelihood of an outside appointment increases significantly with the ownership by corporate blockholders. The number of outside directors on the board also increases the probability that an outside successor is appointed. The coefficient on this variable is positive and significant at the 1% level across all specifications. In unreported tests, similar results are obtained if the fraction of outside directors on the board is used instead. Finally, specification 1 shows that outside succession is more likely when the removal of the old president is forced. Specification 2 indicates that outside succession likelihood also increases when turnover is forced and the stated reason is disciplinary. Even when cases where no reason is provided are considered as disciplinary in specification 3, such announcements accompanied by forced turnover significantly increase the likelihood of outside succession. Overall, these results provide evidence that outside succession is disciplinary in nature.

These results are generally consistent with Kang and Shivdasani (1995) who perform a similar analysis for 18 outside appointments in their sample of 174 turnover events. However, whereas they find a positive but statistically insignificant coefficient on forced departures, the coefficient on this variable is statistically significant in our tests. We conjecture that this difference is due to our larger sample size.

For 99 of the 100 outside succession events, we are able to identify the origin of the successor. In 84 cases, the outside successor was previously employed by a blockholder of the firm. Of these, 60 appointments come from the firm's largest shareholder, 11 come from the firm's second largest shareholder, and 4 come from the firm's third largest shareholder. The mean (median) ownership of the sending blockholder is 25.6% (24.85%) when the successor originates from a blockholder. This ownership ranges from a minimum of 1% to a maximum of 61.63%. In 14 cases, the appointment is from a bank. In 13 of these bank appointments, the sending bank is the firm's largest creditor, and in the remaining case, it is the firm's second largest creditor. The sending bank is also a shareholder in all instances in our sample. In two cases it is the largest stockholder, and in eight cases, it is the second largest stockholder. In the remaining four cases, it is among the firm's 10 largest stockholders. In 38 instances, the outside successors come from firms within the same keiretsu. In these intrakeiretsu appointments, the sending firm is typically a bank or a blockholder. In only 14 outside appointments is the successor not previously from a firm that is a blockholder, bank, or a member of the same keiretsu. In

these cases, the successor often originates from a government agency or organization. A similar pattern among outside appointments is also documented by Ursacki (1994).

Given the important role of governance mechanisms during the outside succession process, such appointments provide a natural setting to evaluate the effects of governance mechanisms on firm value. Accordingly, in Table 5, we report the announcement returns for our sample according to whether the successor is an outside hire or an internal replacement using both the market model and the two-stage approach. Both the mean CAR $(-1, 0)$ and CAR $(-1, +1)$ are 0.95% for outside appointments, compared to 0.38% and 0.56%, respectively, for internal appointments. These returns are significant at the 5% level. However, the median CARs for the $(-1, 0)$ and $(-1, +1)$ intervals are significant only for outside appointments. The two-stage CARs display a similar pattern.

To focus more closely on outside succession appointments that are most likely to represent disciplinary events, we further divide the sample according to whether turnover was forced. There are 36 cases where an outside successor is appointed and the outgoing president does not remain on the board. For this subsample, the mean CAR $(-1, 0)$ is 1.70% and the mean CAR $(-1, +1)$ is 1.64% using the market model. These returns are significant at the 1% level. The median returns are also positive and highly significant for these intervals. The two-stage estimates are more pronounced, with a mean CAR $(-1, 0)$ of 2.42%. These results suggest that in this category of turnover, where the influence of governance forces is likely to be the greatest, turnover has an important and statistically significant effect on firm value. In contrast, outside succession announcements where the president remains on the board do not display any evidence of a significantly positive stock-price response.

There are 45 announcements where the successor is hired from within the firm and the outgoing president does not stay on the board. While the average CARs for these announcements are also positive, they display no statistical significance. In fact, both the unadjusted and adjusted median CARs for this subsample lack significance and are consistently negative. The average unadjusted and adjusted CARs for the 271 inside appointments where the president remains on the board are positive and significant at the 10% and 5% levels for the $(-1, 0)$ and $(-1, +1)$ windows, respectively. However, the median CARs for this type of turnover are not significant.

Finally, we consider whether appointments of quasi-insiders, who have prior experience outside the firm but have been with the firm for more than 3 years, have any effect on stock price. Irrespective of whether turnover is forced or unforced, such quasi-insider appoint-

Table 5
Cumulative abnormal returns (CARs) for inside and outside president appointments for a sample of Japanese firms that announced president turnover in the *Nihon Keizai Shimbun* during 1985 to 1990

Type of turnover	Days in relation to initial announcement							
	Market-model CARs				Two-stage CARs			
	-1 to 0		-1 to +1		-1 to 0		-1 to +1	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Outside appointments	0.95 (0.02)	0.05 (0.08)	0.95 (0.02)	0.40 (0.05)	1.14 (0.05)	0.03 (0.20)	1.18 (0.05)	0.48 (0.14)
Inside appointments	0.38 (0.04)	0.12 (0.23)	0.56 (0.01)	-0.12 (0.36)	0.69 (0.04)	0.27 (0.15)	1.04 (0.01)	-0.18 (0.23)
Outside appointment and forced turnover	1.70 (0.00)	1.37 (0.00)	1.64 (0.01)	0.86 (0.01)	2.42 (0.00)	2.11 (0.00)	2.27 (0.02)	1.17 (0.02)
Outside appointment and unforced turnover	0.53 (0.32)	-0.06 (0.83)	0.55 (0.31)	-0.04 (0.52)	0.40 (0.60)	-0.14 (0.71)	0.55 (0.50)	-0.36 (0.89)
Inside appointment and forced turnover	0.48 (0.40)	-0.40 (0.70)	0.48 (0.42)	-0.48 (0.93)	0.85 (0.28)	-0.15 (0.49)	0.80 (0.36)	-0.67 (0.82)
Inside appointment and unforced turnover	0.37 (0.07)	0.22 (0.25)	0.57 (0.02)	-0.06 (0.34)	0.66 (0.08)	0.35 (0.22)	1.08 (0.01)	-0.08 (0.24)
Quasi-inside appointments and forced turnover	-0.22 (0.85)	-0.49 (0.89)	1.36 (0.26)	-0.65 (0.54)	-0.37 (0.80)	-0.72 (0.79)	1.67 (0.30)	-0.94 (0.59)
Quasi-inside appointments and unforced turnover	-0.27 (0.44)	0.25 (0.80)	0.18 (0.72)	-0.21 (0.89)	-0.44 (0.41)	0.22 (0.71)	0.23 (0.76)	-0.39 (0.96)

Appointments are determined to be from the outside if the new president joined the firm within the last 3 years. Market model CARs are computed using days -220 to -20 as the estimation period for market model parameters. Two-stage CARs are computed by weighting the market model CARs by the reciprocal of $(1 - p)$, where p is the estimated probability turnover from the logit model in Section 4.1; P values are in parentheses. Turnover is considered to be forced if the president does not remain on the board. Turnover is considered to be unforced if the president remains on the board.

ments are not associated with significant CARs over either the 2-day or 3-day interval.

To provide some perspective on the magnitude of the stock-price effects documented, Table 6 summarizes the 2-day CARs reported by several studies of top management turnover in the United States. For a sample of firms from 1975 to 1982, Furtado and Rozeff (1987) document a statistically significant 0.95% 2-day return. A marginally significant 0.28% effect for CEO removals is documented by Weisbach (1988) from 1974 to 1983. Over a period most comparable to this study, Denis and Denis (1994) document a significant 0.63% announcement effect for CEO removals between 1985 to 1988. This estimate is comparable to the 0.52% 2-day return documented in this article. Bonnier and Bruner (1989) attempt to overcome the contaminating effects of adverse information in turnover announcements by examining firms whose poor performance was publicly known. For a sample of underperforming firms from 1969 to 1983, they document significantly positive announcement day returns of 2.48%. However, given the nature of their sample selection criterion, our results are not directly comparable to theirs. Furtado and Rozeff (1987), Park and Rozeff (1994), and Warner et al. (1988) also examine announcement returns for outside succession, and find no significant effects. However, for a subset of firms where a disciplinary reason was indicated in the announcement, or turnover was forced with an outside appointment, Denis and Denis (1994) document a 2.50% stock-price effect. In comparison, we find a 2.24% response when turnover is forced and a disciplinary reason is indicated, and a 1.70% response when turnover is forced and the successor is an outsider. Thus, the announcement period returns documented in this article for Japanese presidential turnover are larger in magnitude than those in most U.S. studies, but are comparable to those documented in Denis and Denis (1994).

3.3 Additional tests

In this section we discuss the results of untabulated tests regarding three additional issues that we investigate.

First, given that the firms in our sample are on average substantially smaller than those in Kaplan (1994), we examine whether the stock-price effects differ among smaller and larger firms. We bifurcate our sample using the median sales value. We find that on average the 2-day CAR is 0.56% for large firms and 0.48% for small firms, both of which are statistically significant. Forced turnover announcements are associated with a 2-day CAR of 1.16% for large firms compared to 0.91% for small firms. The average CARs for outside appointments are also similar: 0.93% for large firms compared to 0.97% for small

Table 6
Summary of average 2-day cumulative abnormal returns (CARs) documented by studies of CEO turnover in the United States

Author(s)	All turnover events	Forced departures	Outside succession
Furtado and Rozeff (1987)	0.95***	N.R.	0.72
Warner, Watts, and Wruck (1988)	-0.26	0.14	0.34
Weisbach (1988)	0.28*	N.R.	N.R.
Bonnier and Bruner (1989)	2.48**	N.R.	N.R.
Park and Rozeff (1994)	-0.07	N.R.	0.61
Denis and Denis (1994)	0.63**	2.50**	N.R.

N.R. indicates not reported. ***, **, *, interpreted as being statistically significant at the 1%, 5%, and 10% level, respectively, by the author(s).

firms. None of the differences in CARs across large and small firms are statistically significant.

Second, we examine whether the observed announcement returns depend upon whether the firm is in a declining industry. For the 92 firms where the prior industry stock return is negative, the 2-day CAR is 0.28% compared to 0.59% when industry stock return is positive. For forced turnover, firms in declining industries experience a 2-day CAR of 1.80% compared to 0.80% for healthy industries. Outside appointments in declining industries are associated with a 0.50% average CAR compared to 1.09% for healthy industries. However, none of the CARs across healthy and declining industries are statistically different. We further examine the effects of firm size and industry performance in a regression framework below.

Finally, we test for possible leakage of information regarding the turnover during the 20 trading days prior to the newspaper announcement. Over this interval, the mean (median) CAR (-20, -1) is 0.95% (0.12%). Neither of these is statistically significant at the 10% level. We also follow the approach outlined in Binder (1985) and test for leakage over this period by using a dummy variable for the 20 trading days before the announcement when the market model parameters are estimated as a system of seemingly unrelated regressions. We find no evidence of leakage using this approach.

4. Regression Results

4.1 All appointments

As discussed by Hirshleifer and Thakor (1994), announcement period returns for management removals are likely to reflect two components: the expected change in firm value as a result of the turnover and

the information revealed by the replacement decision. If Japanese governance mechanisms remove managers when their superior information indicates that managerial performance is adverse, the announcement will convey negative information, which will lower the observed announcement period returns. We examine whether such an adverse information effect is present in our data by a cross-sectional analysis of announcement period returns. Following Bonnier and Bruner (1989), we hypothesize that the worse is the publicly available information about firm performance, the lower will be the adverse information revealed by the announcement. Thus, we expect that the announcement period returns will be negatively related to prior firm performance.

Table 7 reports regression results where the dependent variable is the 2-day CAR over the $(-1, 0)$ interval. To account for potential heteroscedasticity, weighted least squares estimation is employed, where all observations are scaled by the standard error of the prediction errors over the $(-1, 0)$ interval. The regressions include the prior industry-adjusted stock return, the industry stock return, and firm size. To control for any potential time and industry effects, we also include 5 dummy variables for the year of turnover and 25 dummy variables for industry. To conserve space, the table does not report coefficients on these time and industry dummies. The results are similar if time or industry effects are not controlled for. The regressions also control for ownership structure, keiretsu, and main bank ties. To the extent that the market's ex ante assessment of turnover probability varies with the governance structure, inclusion of these variables can control for such anticipation effects. Three specifications that differ in the manner in which turnover is classified are estimated, depending on whether turnover is forced and the stated reasons. Because these two measures may not capture all the disciplinary removals in the sample, we also include the early departure variable, which considers presidents as departing early if their tenure is less than the historical average for the firm.

The coefficient on prior industry-adjusted stock returns is consistently negative and significant at the 5% level across all specifications. This is consistent with the view that turnover announcements reveal adverse information about managerial performance. An alternative explanation is that for poorly performing firms, the potential for improvement in firm value is greater. Across all three models the coefficient on the early departure variable is positive and significant at the 5% level. In model 1, where turnover is classified according to whether the president remains on the board or not, the coefficient on the forced turnover variable is positive and significant at the 10% level. Thus, forced departures are accompanied by higher announcement period returns than are unforced departures. Model 2 shows

Table 7
Weighted least squares regression estimates of 2-day cumulative abnormal returns (CARs)
for a sample of Japanese firms that announced president turnover in the *Nihon Keizai*
***Shimbun* from 1985 to 1990**

Explanatory variables	(1)	(2)	(3)
Intercept	0.008 (0.78)	0.013 (0.66)	0.012 (0.68)
Log (market value of equity)	-0.001 (0.77)	-0.001 (0.70)	-0.000 (0.81)
Prior industry stock return	-0.020 (0.09)	-0.019 (0.12)	-0.021 (0.08)
Prior industry-adjusted stock return	-0.006 (0.03)	-0.006 (0.04)	-0.007 (0.03)
Main bank	-0.002 (0.70)	-0.002 (0.65)	-0.002 (0.75)
Keiretsu	-0.003 (0.41)	-0.004 (0.34)	-0.003 (0.42)
Ownership by financial blockholders	0.000 (0.62)	0.000 (0.62)	0.000 (0.72)
Ownership by corporate blockholders	-0.000 (0.82)	-0.000 (0.99)	-0.000 (0.70)
Ownership by directors	-0.000 (0.48)	-0.000 (0.41)	-0.000 (0.50)
Number of outside directors	0.001 (0.40)	0.001 (0.38)	0.000 (0.56)
Early departure	0.008 (0.05)	0.008 (0.04)	0.009 (0.03)
Forced turnover	0.008 (0.09)		
Forced turnover and reason is disciplinary		0.020 (0.04)	
Forced turnover and outside appointment			0.017 (0.02)
Forced turnover and quasi-inside appointment			-0.007 (0.56)
Adjusted R^2	0.06	0.07	0.07
F statistic (model p value)	1.59 (0.01)	1.63 (0.01)	1.65 (0.01)
Number of observations	361	361	361

Turnover is considered to be forced if the president does not remain on the board. Turnover is considered to be unforced if the president remains on the board. Appointments are determined to be from the outside if the new president joined the firm within the last 3 years. Appointments are determined to be quasi-inside if the new president has previous experience with another organization but joined the firm more than 3 years ago. Departures are considered early if tenure is less than the firm's historical average. The regressions include 5 dummy variables for the year of turnover and 25 dummy variables for industry. P values are in parentheses.

that the abnormal returns for forced turnover accompanied by a disciplinary reason are significantly higher than other announcements. In model 3 we consider forced turnover accompanied by appointments of outsiders and quasi-insiders. Forced turnover with an outside appointment experiences significantly higher returns than other types of turnover. However, the coefficient on the variable for forced turnover accompanied by a quasi-inside appointment is not significant.

The coefficient on firm size is not significant in any specification, indicating that the results documented do not vary systematically across large and small firms. The coefficient on industry performance is consistently negative and marginally significant in models 1 and 3. These results provide weak evidence that turnover in poorly performing industries is viewed favorably by the market. Finally, the coefficients on all governance variables are not statistically significant in any specification. Overall, these regression results indicate that turnover announcements convey adverse information regarding managerial performance to the market, and support the univariate results documented in the previous section.

4.2 Outside appointments

Since involvement of large shareholders and banks underlies almost all of the outside appointments in the sample, we conduct a closer analysis of the stock-price effects of such announcements. In the context of U.S. corporations, Barclay and Holderness (1989) and Barclay, Holderness, and Pontiff (1993) argue that block ownership confers private control benefits that are not available to public shareholders. In the current context, their analysis suggests that large shareholders may be able to obtain such private benefits by sending one of their own executives as an outside appointment to the appointing firm. If the consumption of such benefits is detrimental to the wealth of diffuse shareholders, we would expect such appointments to be associated with lower, or negative, announcement returns. While the univariate results indicate that outside appointments are associated with positive announcement returns, this analysis can mask potential nonlinearities between block ownership and announcement period returns.

To evaluate the effects of ownership by the sending blockholder, Table 8 presents regression results where the dependent variable is the market model CAR $(-1, 0)$ for the sample of outside appointments. All regressions include 5 dummy variables for the year of turnover and 25 dummy variables for the firm's industry. Except as otherwise noted below, the results are similar if these variables are excluded. Column 1 examines whether the announcement return is related to the ownership by the sending blockholder. The coefficient on this

Table 8
Weighted least squares regression estimates of 2-day cumulative abnormal returns (CARs)
for a sample of 99 Japanese firms that announced outside successors in the *Nihon Keizai*
***Shinbun* from 1985 to 1990**

Explanatory variables	(1)	(2)	(3)	(4)
Intercept	−0.022 (0.28)	−0.015 (0.52)	−0.018 (0.75)	−0.025 (0.65)
Log (market value of equity)			0.000 (0.93)	0.001 (0.75)
Prior industry stock return			−0.035 (0.32)	−0.036 (0.30)
Prior industry-adjusted stock return			−0.014 (0.20)	−0.016 (0.15)
New appointment			−0.005 (0.62)	−0.004 (0.69)
Same keiretsu			0.008 (0.47)	0.012 (0.30)
Bank appointment			−0.007 (0.63)	−0.020 (0.23)
Sending blockholder ownership	−0.000 (0.36)		−0.000 (0.46)	
SENDBLK0_10		−0.002 (0.45)		−0.001 (0.81)
SENDBLK10_20		−0.002 (0.35)		−0.004 (0.12)
SENDBLK20_30		0.002 (0.60)		0.003 (0.37)
SENDBLK30_40		0.001 (0.69)		0.000 (0.85)
SENDBLK_ABOVE40		−0.000 (0.83)		−0.000 (0.99)
Adjusted R^2	0.29	0.28	0.25	0.27
F statistic (p value)	2.35 (0.00)	2.18 (0.00)	1.95 (0.01)	1.94 (0.01)
Number of observations	99	99	99	99

SENDBLK0_10, SENDBLK10_20, SENDBLK20_30, SENDBLK30_40, SENDBLK_ABOVE40 are piecewise linear variables of the ownership of the sending blockholder with turning points of 10%, 20%, 30%, and 40%, respectively. The regressions include 5 dummy variables for the year of turnover and 25 dummy variables for industry. P values are in parentheses.

variable is statistically indistinguishable from zero. In column 2 we use a piecewise linear model with turning points of 10%, 20%, 30%, and 40%. This specification also does not indicate a systematic relation between the announcement return and ownership of the sending blockholder. We experiment with alternative turning points in unreported tests and obtain similar results.

Columns 3 and 4 control for other variables that could be related to announcement returns. We include a dummy variable to distinguish between new appointments to the board and outside successors who have been on the board for up to 3 years. The regressions also include dummy variables that equal 1 if the successor is appointed by a firm in the same keiretsu (according to Industrial Groupings in Japan), or by a bank. The regressions also control for firm size and prior industry-adjusted and industry performance. Inclusion of these additional variables does not alter the significance of the variables representing blockholder ownership. The results also indicate that appointments by banks or by firms in the same keiretsu do not lead to significantly different returns than other appointments. The coefficient on the new appointment variable is also not statistically significant. Finally, the coefficient on industry-adjusted performance, though negative, is not significant. If dummy variables controlling for year and industry are excluded however, this coefficient is negative and statistically significant.

One possible explanation for the lack of a significant relation between announcement returns and ownership by sending blockholders is that blockholders have effective control over most Japanese corporations. Thus, if decisions by blockholders are always value-enhancing, irrespective of their ownership stake, we would not expect to detect a relation between announcement returns and blockholder ownership. It is also possible that disciplinary decisions are made jointly by the firm's other blockholders, and not just the sending blockholder. To examine this second possibility, we estimate the Table 8 regressions using ownership by all of the firm's corporate and financial blockholders, but obtain similar results.

5. Summary and Conclusions

We provide evidence that announcements of turnover of top managers in Japan result in statistically significant wealth gains. The announcement period returns are significantly positive and greater in magnitude for forced turnover than for announcements of unforced turnover. We also find that governance mechanisms are particularly active during outside succession. The likelihood of outside succession increases with ownership by corporate blockholders and outside directors on the board. The announcement period returns are statistically significant when turnover is forced and the successor is appointed from outside the firm. These results suggest that the disciplinary actions by governance mechanisms in Japan increase shareholder wealth. However, results from regressions also suggest that turnover announcements are accompanied by the revelation of ad-

verse information. Thus, the observed stock-price reaction is likely to be a conservative estimate of the improvement in underlying firm value. To the extent that Japanese governance mechanisms pursue objectives other than shareholder wealth maximization, our evidence suggests that at least during top management turnover, pursuit of such objectives enhances shareholder wealth.

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