RESEARCH BRIEF

Center for Executive Succession

EARNINGS MANAGEMENT BY INTERIM CEOS TO INFLUENCE CEO SELECTION PROCESSES

Companies are increasingly turning to the use of interim CEOs in the succession process. Interim CEOs have a strong desire to be named to the CEO position permanently; however, little is known about when interim CEOs may be retained. New research which is forthcoming in the *Academy of Management Journal* suggests that interim CEOs engage in earnings management to illustrate higher performance to influence key stakeholders to retain them, without undertaking substantive strategic actions.

Key Takeaways:

- Interim CEO successors are 35.7 percent more likely to engage in earnings management as a means to boost short-term performance than non-interim CEO successors.
- Interim CEO successors who manage earnings are 6.1 percent more likely to be named permanent CEO.
- Effective boards of directors and greater analyst coverage of the company reduce the likelihood that an interim CEO who manages earnings will be named the permanent successor.

Examining 138 interim succession events, the researchers found that interim CEOs were 35.7 percent more likely to engage in earnings management to improve short-term perceptions of firm performance than non-interim CEO successors at similar firms. Further, interim CEOs who engaged in high levels of earnings management were 6.1 percent more likely to be named permanent CEO than interim CEOs who engaged in average levels of earnings management. At the same time, internal and external governance in the form of financial expertise on the board, boards of directors without other responsibilities as directors, and greater coverage by financial analysts reduced the likelihood that an interim CEO who managed earnings was named permanent CEO. For instance, when the board lacks financial expertise, interim CEOs who manage earnings are 18.9 percent more likely to be named CEO, while interim CEOs are only 3.0 percent more likely to be named permanent CEO when the board has greater financial expertise. Despite these findings, companies who promoted interim CEOs to permanent CEO failed to outperform companies who did not promote the interim CEO. These results suggest that earnings management serves the needs of the interim CEO, without improving the company.

In summary, new research illustrates how interim CEOs manage perceptions of their ability to increase the likelihood of promotion to permanent CEO. In particular, interim CEOs are more likely to engage in earnings management, which increases the likelihood that they are selected full time. Companies may counteract such problems by ensuring effective governance mechanisms exist which fail to reward earnings management by interim CEOs.

Source: Chen, G., Luo, S., Tang, Y., & Tong, J.Y. (Forthcoming). Passing Probation: Earnings Management by Interim CEOs and Its Effect on Their Promotion Prospects. *Academy of Management Journal*.