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Appointment of new CEO and firm share price: Evidence from Tesco PLC, UK

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Abstract

This paper assessed the impact of the appointment of new CEO on the firm share price using a UK based company as a case study. The share price of a firm is influenced by several factors particularly its performance. The performance is in turn influenced by the management team, the quality of the management or trust in the management capacity of a firm could play a role in its market value. Thus, the announcement of a new management team or officers such as CEO could have far reaching effect on share price. Tesco Plc for several years witnessed decline in its share price. This informed a restructuring of the management team by appointment of a new CEO on 21st July, 2014. The paper used three window periods that is day before, on and after the announcement. Data on share price and volume of the share traded was generated from yahoo finance and simple percentage statistic was used to analyze the data. The result shows an increase of 1.91% in the company's share price before that date. The general market price of share quoted revealed on FTSE100 on the same day rather decrease by 0.31% which is an indication that Tesco Plc's share price increase cannot be attributed to the general market condition but to specific event which is announcement of the new CEO. Therefore, this paper recommended that the new CEO should be given welcome package and other incentive which may encourage him to stabilize the company's poor corporate governance thereby bringing a good reputation to the company that may cause investors to react positively.

Keywords: CEO appointment, investors' reaction, market share price

Introduction

Tesco PLC, through most of its subsidiaries operates as a food general merchandise retailer. The Company also offers online retailing, brick and mortar supermarkets as a private-label brand of products. Tesco provides its services primarily throughout Europe, with additional activities in Asia and Americas. It has stores in 12 different countries across Asia, Europe and America and is the grocery market leader in the United Kingdom where it has a market share of around 28.4% in Ireland, Hungary, Malaysia, and Thailand (Tesco Annual Report, 2014) [18].

Tesco was founded in 1919 by Jack Cohen as a group of market stalls. The majority of Tesco's stores (branches) are still in the United Kingdom; 3,376 out of 6,351 stores (branches) are still there as of April 2015. The company was quoted in the London Stock exchange on 23rd December, 1947 with market capitalization of £15,847.95. Thus, the company's shares are traded on FTSE100 share index (Bloomberg, 2016) [2].

According to Uyar and Kilic (2012) [20] the determinants of market price may include the following: The nature of the marketing strategies, the objective of the marketing mix strategy and demand decision, the competitors cost and other environmental organisational factors such as economy and government. They further added some internal factors that affect the company's market price and these are product quality, leadership, performance quality and research and development. However, apart from those factors that determine the market price the company's management team have an influence on the market place. Thus, they influence the market through marketing strategy. Marketing strategy is a plan developed by the management that describes how company's products and services will be offered to customers (Charitou, Patis and Vlittis, 2010) [3]. However, Wolk, Dodd and Rozycki (2013) [21] argued that management's marketing strategy can be influenced through the main five external factors and these factors are known as SLEPT which comprises social, legal, economical, political, and technological. They further state that competition can influence the company's marketing strategy externally.

According to guardian (2015) [19] before and after the resumption of Alan Stewart as the new Chief Financial Officer and the Mr. Dave Lewis as the new CEO, Tesco Plc is facing some of the following challenges:

Trading: Tesco Plc put on a good show over Christmas, outperforming expectations by placing thousands of extra staff on the shop floor and tempting shoppers back from the discounters with special offer. The latest industry figures suggest momentum has slowed as rivals such as Aldi and Asda have both cut prices further. Therefore, one of the management first priorities will be to work on where and how Tesco should be cutting prices or using its Club card and advertising to get shoppers back through its doors.

Morale: One of the first moves by Tesco chief executive Mr Dave Lewis, who arrived in September, 2014 was to put more staff on the shop floor in an attempt to improve service. But Tesco has also been going through some process with tiers of management to remove stores and thousands of jobs going at its head offices. However, according to Telegraph Media Group Limited (2014) [17] Tesco wants to win back shoppers and motivate the staff.

This study upon investigating on the impact of market reaction on share price as a result of the announcement of the new CEO, using the three windows period that is before, during and after the announcement date of the new CEO. Considering the telegraph read and Tesco's 2014 annual report, one may conclude that the appointment of Tesco new CEO was as a result of decreased in revenue and profit that the company experienced for the past three years which occurred as a result of poor performance of the formal Chief Executive Officer and the resignation of the Chief Financial Officer on April, 2014.

Consequently, this study as part of the effort of investigating the impact of the announcement of the new Chief Executive Officer in the grocery company its main objective is to determine whether there is market reaction around the announcement date of the new CEO in Tesco PLC using 2014 company's annual report and yahoo finance as a source of information. The justification of this research work is that, it will be benefit to the financial managers when making their report concerning the company's profit and the financial analyst when finding out the impact of the companies price. It would also assists the investors when making an investment decision and it will create room for further research in different companies that appointed a New Chief Executive Officer.

Literature Review

Historical Background

Tesco PLC is a grocery company which was established in 1919 in London by Mr Jack Cohen when he started selling surplus groceries from a stall in the east London its brand first appeared five years later in 1924 when Mr Cohen bought a shipment of tea from Mr. Stockwell, from there he opened a flagship Tesco store in Burnt Oak, North London. Tesco brand continue to rise in 1930 when Mr. Cohen built a headquarters and warehouse in North London and in 1932 it became a private limited company. In 1947 Tesco Stores Holdings Ltd floated in the stock exchange with a share price of 25p (Tesco Annual Report, 2014) [18]. The majority of Tesco's stores (branches) are still in the United Kingdom, because 3,376 out of 6,351 stores (branches) are still there as of April 2015. The company was quoted in the London Stock exchange on 23rd December, 1947 with market capitalization of £15,847.95. Thus, the company’s shares are traded on FTSE100 share index (Bloomberg, 2016) [2].

Tesco.com was launched in 2000 and the super market continued to growth in a range of products which include clothes, electrical and groceries products. Tesco was successful and continued to expand until 2013 when it faced drop in profit and reported its worst performance. Due to the persistent poor performance on July 10, 2014 Tesco announced the appointment of Alan Stewart as the new Chief Financial Officer. Thus, as a result of profit warning at the same date Philip Clark step down as CEO then Mr. Dave Lewis was announced as his successor, the company also issues a second profit warning in August 18 and also slashes its dividend on August 29, 2014 and reveals that Mr. Lewis will take up his role a month earlier than planned before. Consequently, Tesco Plc shocked the market on September 22, 2014 when they have over stated its half-year profit forecast by £250m (Tesco Annual Report, 2014) [18].

Empirical review

The primary objective of this study is to examine the market reaction on the share price as the result of the announcement of the new CEO but taken into cognisance the three windows period that before, on and after the announcement date. Thus, in order to achieve this objective various literature on the impact of new CEO announcement on the announcement date and market reaction (price) were reviewed. Studies conducted in this area found different results depending upon the period and the countries under investigation by the researchers. Foster (1986) [8] argues that market react as a result of the announcement of the new CEO. Most of the literature reviewed focused on the dynamics of market of outside directorship but this study assumed that market reward manager from the firm that perform above the average expectation. Hence, there are diverse expectations about market reaction to the new CEO appointment. Therefore one of these possibilities is a company voluntarily making such change seeks to obtain the benefits of redirection of its strategic leadership expecting performance improvement as a result (Hail, 2002) [10]. But if mismanagement of strategy, vision and objectives contributed to the financial problems for the firm, a change in leadership is expected to reverse this problem by ensuring a good strategy in the company. Thus, as a result of this improvement investors will regard it as their future expectation about the company's cash flows and this will automatically reflected positive reaction of the investors on the share price about the news of the new CEO appointment.

Accounting disclosure has based known to impact capital market. Studies show disclosure by the management, analyst and press release causing market to react. Kothari, Li and Short (2009) [11] stated that incentive facing the management, analyst and business news may affect the content of their disclosure in different ways for example management and analyst reports may have a stronger incentive because it is optimistic in nature whereas, business report may have weaker incentive. Disclosure of the accounting information that is required by the accounting regulators has an impact on the capital market either by the corporate management through annual report, by media through business releases or by the analyst (Deegan and unerman, 2011) [7].

In addition, apart from the announcement date there are various factors that could affect the market reaction. Frankel, Kothari and Joseph (2006) [9] described the factors relating to disclosure of information by the analyst in two ways positively correlated and negatively correlated. Positively correlated information according to Frankel, Kothari and Joseph (2006) [9] relate to high returns on volatility which causes uncertainty in the security of cash flow thereby giving the investors chance to gain from this information.

Kothari, Li and Short (2009) [11] found that if the content of the analyst information shows a favourable disclosure, the firm's cost of capital and stock volatility in an analyst earning forecast decline significantly, whereas, when the content of the analyst information shows unfavourable disclosure then the firm's cost of capital and stock volatility increases significantly. Consequently, positive news on disclosure by the management do not significantly affect the firms cost of capital but when they offer negative news then it will increase return volatility. Lacina and Karim (2004) [12] argued that the effect of market reaction is dependent upon the earnings announcement which may have a great impact on the company's share price, even though it depends on the size of the company. Firms with larger size might have more information available in the market and therefore the greater possibility of forecasting the earnings already enclosed in the share price. Therefore, the relation between the accounting information and changes in the market price are more significant for the smaller firms but less significant for the larger firms since the possibility of earnings forecast is already enclosed in their share price.

Denis and Denis (1995) [6], Foster (1986) [3], Dahyaa and McConnel (2005) [5] and Lacina & Karim (2004) [12] in their studies focused on impact of market reaction as result of announcement of insider to be the new CEO. This study examined the impact of market reaction as a result of the announcement of the outsider to be the CEO in Tesco Plc.

Factors that causes market reaction

The market price of the company refers to the economic price for which a good or service is offered in the market place. Thus, the market value and market price are equal under conditions of market efficiency, equilibrium and as well as rational expectation. However, Uyar and Kilic (2012) [20] state that determinants of market price may include the following: The nature of the marketing strategies, the objective of the marketing mix strategy and demand decision, the competitors cost and other environmental organisational factors such as economy, consideration resellers and government. They further added some internal factors that affect the company’s market price and these are product quality, leadership, performance quality and research and development. However, apart from those factors that determine the market price the company management team have an influence on the market place. Thus, they influence the market through marketing strategy. Marketing strategy is a plan developed by the management that describes how company’s products and services will be offered to customers (Charitou, Patis and Vlittis, 2010) [3].

Some of the important economic or regulatory factors that cause the possible reaction of the market include inflation, cost price and demand. Tesco as a grocery company faced challenges from sales which gives an opportunity for its rival competitors like Lidl Plc. to take most of the Tesco's investors during the year 2014.Other factors include; Looking through the Tesco annual report for 2014 there was a lot of changes in the corporate governance and resignation of key officers, for example the Chief Financial Officer's resignation and non-payment of the executive remuneration due, failure of the board in meeting their target among others are some of the reasons that affect the company's revenue and hence causing the investors reacted negatively towards the Tesco's market price.

Uyar and Kilic (2012) [20] described the factors relating to disclosure of information by the analyst in two ways positively correlated and negatively correlated. Positively correlated information according to Michael (2011) [11] are those factor that will cause market reaction as a result of high returns on volatility which causes uncertainty in the security of cash flow and also the trading volume which is as a result of either the brokerage house offering services to analyst in order to increase their commission or heterogeneous information. Other positively related factors are institutional ownership as a result of crucial needs of the analyst disclosure to stock price.

The CEO has a key function in determining the company's strategy and performance, as such the stakeholders and investors could possibly view the CEOs appointment as either capable of creating future success, that is positive reaction or it can result in failure of the company (Charitou, Patis and Vlittis, 2010) [3]. It also ensured the company's financial statements are prepared in accordance with statutory laws and in accordance with the requirements of the accounting standards. He also designed the company's strategy in order to compete with other competing companies in the financial market (Setiawan, 2008).

There are different studies that have been carried out in determining the impact of market reaction as a result of announcement of the appointment of the new CEO of companies in many countries, using different techniques, but this study assumed market reaction can be determined using three windows period that is before, during and after the announcement of the appointment of the new CEO.

Cool and Van praag (2007) [4] studied market reactions to top CEO turnover announcement in Netherlands. During their investigation they used stock price movement and trading volume approaches in order to measure the company's market reaction. Their findings showed that there is no significant abnormal return around the announcement of the top executive turnover. Thus, in their study they did not investigate the prices before the announcement date, but this study will investigate the investors’ reaction on and before the announcement date of the appointment of the new CEO in Tesco Plc.

Xu, Zeng, and Tam (2012) [22] found that the press release played an important role for the stock market because investors react positively to the media on the information about environmental activities. Therefore, media disclosure makes investors to react to the market whether there is good news or bad news. Hence, Neomann and Voetmann (2005) [15] investigated the market reaction to CEO turnover announcement in Denmark and their sample consisted of 39 non-routine changes and the voluntarily changes for the period of 1994-1998 and their finding showed a positive result to non-routine changes and negative to the voluntary changes. This study, however investigate investors’ reaction to Tesco Plc prices at the announcement of the appointment of the new CEO.

Setiawan (2007) [16] found that in his investigation that Indonesia investors react to non-routine turnovers when the successor was appointed from outside the firm to be the new CEO of the company. Conclusively, after the researcher reviewed the literature of the previous researchers he found that most of the literatures do not study on three windows period that is before, during and after the announcement of the appointment of the new CEO of the companies.

Methodology

This study used the event study approach. The objective of this study is to observe the changes in the share price and the trading volume before, during and after the announcement of the appointment of the new CEO of Tesco Plc. The researcher selected Tesco Plc to be the case study, because the share price of the company was changed immediately after the announcement of new CEO. Yahoo finance was used as a source to generate data of the price changes; a simple table was form to elucidate how these prices are changed from one period to another. The changes in the Tesco's price occurred as a result of market reaction during the three windows period. Thus, this study used event study method to make an observation on the different prices generated from yahoo finance, in order to discuss the possible reaction of investors with regards to Tesco's corporate governance. Looking through the Tesco annual report for 2014 there was a lot of changes in the corporate governance and resignation of key officers, for example the Chief Financial Officer's resignation and non-payment of the executive remuneration due, failure of the board in meeting their target among others are some of the reasons that affect the company's revenue and hence causing the investors reaction toward the price.

Corporate governance describes the ways in which company is directed and controlled by the board of directors (Bava & Devalle, 2012) [1]. Therefore, Maria (2009) [13] argued that changes in the corporate governance and non-payment of the executive remuneration will make investors react towards market. The resignation of Chief Financial Officer early 2014 brought changes in the company's strategies since the new Chief Financial Officer will get some obstacle in dealings with some financial issue which may affect the company's sales and profit. Thus, the researcher studied the event that happens in the Tesco Plc as a result of the announcement of the appointment of the new CEO. The date for this event study was for three day, that is before, during and after the announcement of the new CEO no date was tested for the purpose of the research but a mere observation was made in order to explain tragedy that occurred. Therefore, in order to make investors have more confidence in the Tesco Plc performance and the analysts to ease their investigation on market reaction yahoo finance has been used as a source of finding enough data regarding the Tesco's share price.

Results and Discussion

The CEO is a person who holds an important position in the company. He also designed the company's strategy in order to compete with other competitive companies in the financial market (Setiawan, 2008). Thus, Chief Executive Officer's poor performance would directly affect the company's share price and the investors' reaction also affects the company's. On the other hand, looking at the company's annual report the researcher observed that no remuneration has being given to the directors in the year 2014 because the company did not meet its target and there was a lot of changes in the company's corporate governance and performance such as resignation and chasing out of some key officer also singling a problem in the company that may cause market reaction.

The market reaction as a result of the announcement of the new CEO of Tesco Plc has brought some changes in the share price. The table 1and 2 below shows the changes in the market price and volume trade for the Tesco before the announcement date, at the date of the announcement and a day after the announcement. Table 1 below shows the different price of Tesco Plc generated from the yahoo finance to serves as the data for the event study observation since this research does not used any hypothesis:

Table 1: This shown how share price of Tesco Plc are changing on different dates

Tesco Plc						
Date	Open	High	Low	Close	Volume	Adj Close
22/07/2014	285	285.63	276.67	277.35	34084400	275.49
21/07/2014	294.1	295.2	284.81	288.65	49954000	286.72
18/07/2014	284	285.55	281.8	285	15394100	283.09

***Source*:** (Yahoo finance).

Table 2: This shown how share price in FTSE100 are changing on different dates

FTSE100						
Date	Open	High	Low	Close	Volume	Adj Close
22/07/2014	6728.44	6801.84	6728.44	6795.34	0	6795.34
21/07/2014	6749.45	6753.42	6715.78	6728.44	0	6728.44
18/07/2014	6738.32	6749.89	6690.9	6749.45	0	6749.45

***Source*:** (Yahoo finance).

For clarification purpose, FTSE100 means the share index of 100 companies listed in London Stock Exchange with the highest market capitalization. Looking at the table1 above the Tesco's close share price before the announcement date that is on the 18th of July, 2014 was £285.0 with trade volume of 15,394.100 but the price was slightly up by 1.91% on the date of the announcement that is 21st July, 2014 making the price to become £288.65 with trade volume of 49,954,000. Subsequently, the price fall down by 2.37% the following day after the announcement of the appointment of the company's new Chief Executive Officer with £277.35 and with a trade volume of 34,084,400. On the other hand, comparing the Tesco Plc overall market price changes with the market price of FTSE100 in table 2 above the researcher found that there was a slight difference, because FTSE100 market price on the day before the announcement of the new CEO of Tesco that is 18th of July was £6,749.45 then slightly decrease with 0.31% unlike the Tesco's price which increased on that particular day, making the price of FTSE100 fell to £6,728.44 on the announcement date. However, the price shoot up to £6,795.34 that is showing 0.99% increase in the market price, unlike the Tesco's price that drop by 2.37% that same day.

According to telegraph news (2014) the new CEO of the Tesco took over on September 1, 2014 but the outgoing CEO will remain with Tesco to assist new chief executive officer either directly or indirectly up to January 2015. Thus, the outgoing Tesco's CEO will receive a full benefit for the next six months. The new executive officer will receive a welcome package in lieu of his current year bonus from his formal working place (Unilever Plc.). Thus, this plan could also make investor think that the company may have problem in the future as such they react either positively or negatively.

Other possible reasons that cause the investors react toward the market can be look in different ways for example, if the firm is making a change in order to obtain benefit from redirecting of its strategic leadership that will improved the firm's performance or it mismanagement of the strategy, vision, mission and management objective is creating financial problems in the company. Therefore, changes in leadership is expected to reverse this trend by improving firm strategies (Charitou, Patis and Vlittis, 2010) [3].

Conclusion and Recommendation

Market reactions have significant impact as a result of the announcement of the new CEO in Tesco Plc Thus, announcement of the appointment of the new CEO of Tesco Plc on the 21th of July, 2014 was embraced by investors in a positive way as they assumed that it will reflect in their expectation about the future cash flow, as such there was positive response of the share price on the announcement day which is above the price before the announcement date. Hence, it was hoped that Tesco's price will surge to normal level since the new CEO of the company who replaced Mr. Clark has board experience from one of the listed companies in the United Kingdom that is Unilever Plc. Also the new CEO's leadership will stabilize the company's poor corporate governance in the future thereby bringing a good reputation to the company that may attract more investors. Therefore, it is recommended that the new Tesco's CEO with collaboration of the management should create a strategic policy that will increase its revenue and earnings since the investors are always after the company's performance.

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