

WHEN EXECUTIVE TURNOVER LEADS TO INERTIA

Managerial cognition significantly influences resource allocation decisions. Executive tenure can promote strategic inertia, potentially leading to self-reinforcing narratives and escalated commitments within organisations. A frequently adopted approach to mitigate these issues is to introduce new decision-makers, however, recent findings challenge this approach. Instead, consistency is argued to better address inertia by enhancing responsiveness to feedback in the face of uncertain investments. But how such dynamics manifest in real-world settings is underexplored in the literature. Our study seeks to fill this gap. Our examination of S&P 1500 firms indicates that there is an inverted U-shaped relationship between the extent of turnover and resource reallocation where there is substantial managerial turnover (exceeding 63% of team members), reducing capital reallocation across units. This behaviour implies that new team, due to a limited understanding of the rationale behind previous decisions, adhere to established resource allocation patterns.

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“Since we cannot change reality, let us change the eyes which see reality.”

– Nikos Kazantzakis

INTRODUCTION

Resource allocation decisions are, to a certain extent, predicted by managerial cognition (Hambrick and Mason, 1984). A significant body of research discusses the challenge of organisational inertia and managers' susceptibility to cognitive biases. Executive tenure has been identified as an influential factor in organisational behaviour, particularly as a factor in inertia versus change (e.g., Fredrickson and Iaquinto, 1989, Finkelstein and Hambrick, 1990, Geiger and Antonacopoulou, 2009, Miller, 1991). Research suggests that longstanding executives can often perpetuate self-reinforcing narratives and escalate commitments, thereby reinforcing path dependence within the organisation over time (Geiger and Antonacopoulou, 2009, Miller, 1991). Additionally, such executives frequently exhibit a lack of responsiveness to external pressures, resulting in overinvestment that prioritises quantity at the expense of quality (Pan et al., 2016). The introduction of new decision-makers has been proposed as a means to decrease commitment escalation (Chulkov and Barron, 2019, Kalmanovich-Cohen et al., 2018, McNamara et al., 2002), encourage strategic divestments (Shimizu and Hitt, 2005, Zacharias et al., 2015) and enhance both the quality and quantity of innovation (Bereskin and Hsu, 2012).

Contrary to this conventional wisdom, a thought-provoking paper by Boulding et al. (2017) illustrates that retaining, rather than replacing, a decision-maker is beneficial for addressing project overcommitments. In response to the question 'Do we really need to change the decision maker?' (p. 3459), they discovered that consistency in decision-makers, surprisingly, reduces the propensity for escalation in uncertain scenarios by ensuring greater responsiveness to feedback over time. That is, the decision maker who initiated the investments is more willing to believe that the focal investment may turn out to perform poorly and also gives more weight to negative information. This finding is supported by Long et al. (2020), whose research in multistage projects confirms that consistent decision-makers excel at detecting adverse performance trends and making prompt decisions to abandon failing initiatives (sometimes abandon prematurely).

While research like that of Boulding et al. (2017) and Long et al. (2020) underscores the advantages of retaining the same decision-maker to mitigate project escalation, others point to the drawbacks of decision-maker turnover. Baliga and Ely (2011) suggest that new executives might not have access to essential sunk cost information, leading them to follow the strategies set by their predecessors. For instance, they highlighted the transition in leadership at IBM, where Lou Gerstner, upon becoming CEO, stated, “IBM has yet to test fully many of the changes Akers (prior CEO) put in place ... I want to make sure the current system is implemented before we try any alternatives.” This

observation underscores a scenario where new leadership may tend to continue with established plans due to cognitive constraints, such as lacking firsthand experience of the project's initial conditions. This often results in new managers using previous investment decisions as a baseline, inadvertently reinforcing those commitments (Baliga and Ely, 2011), or even overinvestments (e.g., Brügger and Luft, 2016). Hence, retaining the original decision-maker might be advantageous due to their comprehensive knowledge of the investment history and the rationale behind decisions, while turnover tends to create information gaps and reliance on established investment patterns.

Despite these discussions (i.e., Boulding et al., 2017, Baliga and Ely, 2011, Long et al., 2020, Brügger and Luft, 2016), the literature has yet to conclusively determine the prevalence of these phenomena within actual organisations. There is an extensive body of literature focusing on the dynamics within top management teams (and the role of CEOs; however, our study seeks to delve deeper into the behavioral patterns of managers amidst varying degrees of team turnover). Specifically, we aim to investigate the decision-making processes of new managers who, in their initial phase, might not fully understand the rationale behind the allocation decisions made by their predecessors. Through this study, we aspire to shed light on how these managers navigate their early tenure, particularly when faced with understanding and possibly re-evaluating strategic choices.

Context

Given that the decision-making processes for resource allocation include not just the CEO but other senior executives and divisional managing directors, our analysis focuses on the senior management team. We aim to determine the continuity or departure of individuals responsible for previous investments, thus assessing the preservation or loss of the rationale behind past allocations and critical sunk cost information. For example, if the entire team remains, a collective consciousness of the logic behind previous decisions prevails. This enables us to investigate the relationship between the recognition of past investments and ensuing strategic actions, as underscored by Boulding et al. (2017).

This study is primarily interested in high turnover scenarios, that is, where the majority or all former managers depart from the firm. In these scenarios, plans devised by previous managers were based on the information available at that time; when new managers arrive the original, direct rationale associated with former investment may be lost, at least in part, and managers may not rush to make reallocations, instead maintaining the status quo based on the firm's prior performance. They may not initially change previous investment patterns as they want to familiarise themselves with ongoing trends around those investments (Baliga and Ely, 2011). Consequently, our study investigates how the degree of executive turnover rates affect resource allocation patterns.

METHODOLOGY

Sampling

The study utilises data from COMPUSTAT to obtain details on variables at the business segment, firm, and industry levels between 2001 and 2018. We obtained data on the top management team (TMT) from ExecuComp. The analysis focused on a sample of S&P 1500 companies with at least two business units. Also, we excluded public administration firms and conglomerates (SIC 9100–9999) and financial firms (SIC 6000–6999) due to varying regulatory oversight and different return metrics.

What constitutes a TMT is vague, with no generally accepted criteria and can vary depending from study to study, according to research design and datasets (Krause et al., 2022). We conceptualised the TMT as the top executive team responsible for, and capable of, influencing the capital allocations allocated to business units within multi-business firms. Specifically, we included the highest-level team, comprising the CEO, president, executive vice presidents (VPs), senior VPs and VPs of the firm (following Messersmith et al., 2014). Consistent with Krause et al. (2022), we also deliberately included presidents or managing directors of business units, as they hold influential positions in determining the final allocation of resources. Doing so aligns with our focus on multidivisional firms. Furthermore, considering the impact of COOs on either fostering or hindering firms' strategic actions (Zhang, 2006, Hambrick and Cannella Jr, 2004), we also included COOs. We also ensured the inclusion of unique positions, such as Chief Development, Strategy, Growth, M&A, Restructuring, and Partnership officers, in the team. Almost 97% of our final sample included the CFO of the firm as a part of the leadership team. Other functional leaders were ignored. We also excluded all observations where there were fewer than three team members. The resulting sample comprised a panel of 606 S&P firms repeatedly observed (at least two consecutive years) during the 2001–2018 period, and the dependent variable is continuous.

Independent Variables

Turnover percentage: We adjusted the measure developed by Messersmith et al. (2014). Specifically, the number of executives who left the TMT within a two-year period was then summed and divided by the total number of executives employed by the firm during the same two-year time span to yield an average turnover percentage for each firm. Data corresponding to the base year 2015 includes turnover from 2014 and 2015. For example, if one member leaves a team in Y1 and one in Y2, and if the firm has six members each year, then *TMT turnover* will be 0.17 (two turnovers divided by 12). As turnover may occur later in the fiscal year, and the actions of new team members may not be evident during that period, we deliberately chose a two-year increment to accommodate this

potential bias. Every executive departing from the TMT was categorised as a turnover event, regardless of the reason for their departure as indicated in the ExecuComp database.¹

Table 1 Measure of Member turnover

<i>Example</i>	<i>Year_{t-1}</i>	<i>Year_t</i>	Total
# of members who departed	1	1	2
# of executive members	6	6	12
Member turnover			0.17

All executives, including the CEO, were included in the turnover calculations. Due to the distinctive role of the CEO, we added CEO tenure as a control variable. Also, longer-tenured CEOs have more awareness of past project performances and may subsequently stop escalate. Furthermore, recognising that turnovers could be precipitated by underperformance, behavioural issues, or policy-related challenges (Gentry et al., 2021), we included a dummy to account for instances where CEOs were dismissed for such reasons within the preceding two years. The dataset on reasons for CEO dismissals were sourced from Gentry et al. (2021).

Table 2 Predictor characteristics

	No turnover	Low turnover (>0; < Sample mean)	Moderate turnover (>Sample mean; < mean+ 1SD)	High turnover >Mean+1SD
Member turnover	0.00	<0. 152	<0.274	>0.274
% members replaced	0%	Between 0% and 25.4%	Between 25.4% and 54.8%	More than 54.8%
Observations	1,506	2,130	2,143	1,004
Share	22.2%	31.4%	31.6%	14.8%

Dependent Variable

Our dependent variable is the variation in the degree of capital allocation within the multibusiness firm in a focal year from the last year. This measure was introduced by Vieregger et al. (2017). The measure initially calculates the absolute change in BU(n) capex, expressed as a percentage from the prior year to the focal year, representing the proportion of the firm's total capital expenditures allocated to that specific unit. Then, it sums the absolute values of the proportion changes for each business unit across the entire firm.

¹ Many turnover events lack information about the reason for an executive's departure (Messersmith, et al., 2014). Given these instances of missing data, we incorporate all turnover events into our analysis.

$$Capital\ Reallocation = \sum_n \left| \frac{BU_t^n}{Firm_t} - \frac{BU_{t-1}^n}{Firm_{t-1}} \right|$$

Here, *BU* denotes the capital investment at the business unit level, and *Firm* represents the total capex for the entire company. This metric encompasses all capital expenditures, except for the BU with negative capex, capital expenditures greater than sales, and BU sales of less than \$1 million. We also excluded firms with a single business unit.

For instance, if a company allocates \$100 to Business Unit 1 (BU1) and \$100 to Business Unit 2 (BU2) in year $t - 1$, resulting in a total capital expenditure of \$200, and then in year t invests \$160 in BU1 and \$80 in BU2, maintaining a total expenditure of \$240 (see Table 3; *Example 1*), the proportion of BU1 in year $t - 1$ is 50% (\$100 of the \$200 total), while BU2 is 50%. In year t , BU1's proportion increases to 67% (\$160 of the \$240 total), and BU2 decreases to 33%. The absolute percentage change in proportion for BU1 is 17% (the difference between 50% and 67%), and for BU2, it is also 17% (the difference between 50% and 33%). The overall capital reallocation for the entire firm from year $t - 1$ to t is the cumulative sum of the absolute percentage changes across all business units, amounting to 34%. Thus, firms that shut down projects, divest assets or limit allocations to certain businesses will not have the same allocation pattern as the previous year. Considering firms may increase overall capital allocations, we controlled capex growth separately.

Following, we compared this scenario against a firm exhibiting allocation inertia (Table 3; *Example 2*). The firm adjusted its allocations marginally, with a 2% reduction in investment in BU1 and a concurrent 2% increase in BU2. These adjustments culminated in an aggregate reallocation metric of 4, substantially contrasting with the earlier noted 34%. Notably, the median reallocation among the firms in our study is 15%.

Table 3 Example of the Dependent Variable.

<i>Example 1</i>	BU1	BU2	Total		<i>Example 2</i>	BU1	BU2	Total
Y_{t-1}	\$100 (50%)	\$100 (50%)	\$200 (100%)		Y_{t-1}	\$100 (50%)	\$100 (50%)	\$200 (100%)
Y_t	\$160 (67%)	\$80 (33%)	\$240 (100%)		Y_t	\$97 (48%)	\$105 (52%)	\$202 (100%)
Absolute change	17%	17%			Absolute change	2%	2%	
Overall Reallocation	34%				Overall Reallocation	4%		

Control Variables

The TMT and CEO characteristics also play a role according to the upper echelons perspective (Hambrick and Mason, 1984). We added a dummy if the CEO serves as board chair (i.e., *CEO duality*).

Prior research suggests that where a CEO serves as the board chair, the likelihood of turnover is reduced and the team becomes more risk-averse (reviewed by Krause et al., 2014). *Founders* might often be overconfident and may be less inclined to listen to and inhibit risk-taking (Abebe et al., 2020). Another consideration is the *Presence of a COO*. According to Zhang (2006), building on Hambrick and Cannella Jr (2004), the presence of a COO is likely to result in more strategic change and higher performance when the CEO and TMT lack firm-specific knowledge. However, under low-performance conditions, COOs may act as contenders, challenging the CEO's retention at the helm of the organisation. We accounted for team diversity by considering *Female share*. Perryman et al. (2016) find that companies with increased gender diversity in their TMTs experience lower risk and demonstrate better performance. In contrast, recent research suggests that having more female team members changed strategic orientation and increased risk-taking propensity (Post et al., 2022). Also, *Team size* can have an effect, as a larger team might bring more diverse ideas to the table (Amason and Sapienza, 1997), while age heterogeneity may induce conflicts (Milliken and Martins, 1996). We measure *team size* by the total number of executives, and *age diversity* by the coefficient of variation of their ages.

We also control for firm-specific factors such as *prior performance*, *firm size*, *capex growth*, *acquisitions*, *N of units*, *Unit power*, *dropped units*, and *operational cash flows*. Poor performance may foster strategic resource allocation change and force TMT changes, and good performance often leads to inertia (Miller and Chen, 1994), hence we measure *prior performance* using the lagged value of ROA. We also added the M&A activities of the firm. The *acquisitions* are measured by dividing the acquisition spending by the total assets of the firm. *N of units* may foster better reallocations (Argyres and Lovallo, 2023, Dickler and Folta, 2020) and growth identification (Baghai et al., 2009). Additionally, we accounted for diversification, measuring it as the reciprocal of the share of the largest BU in total company sales. A lower diversification score indicates the predominant political power of a single unit, suggesting that firms are more likely to allocate resources to BUs wielding significant political influence within the organisation (Bardolet et al., 2017). Also, to account for top executives' broad latitude in engaging in large-scale structural change, we added the count of BUs that dropped (*Dropped units*) from the prior period (Vieregger et al., 2017). Finally, the study examines the influence of operational cash flows, relative to total assets, on the focal year's performance metrics.

In addition to analysing reallocations, we conducted further analyses to predict capex growth and divestments (measured as divestment earnings over total assets). This comprehensive approach was designed to provide a more detailed picture of managerial turnover.

Table 4 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Capital reallocation ^ω	6,783	0.22	0.21	0.00	1.06
Member turnover	6,783	0.15	0.12	0.00	0.86
CEO dismissal	6,783	0.05	0.21	0.00	1.00
CEO tenure ^ω	6,621	6.17	5.62	1.00	35.00
COO presence	6,783	0.33	0.47	0.00	1.00
CEO duality	6,783	0.59	0.49	0.00	1.00
Founder in TMT	6,783	0.03	0.16	0.00	1.00
Female share ^ω	6,783	0.06	0.12	0.00	0.50
TMT size	6,783	5.18	0.87	3.00	8.00
Firm performance _{t-1} ^ω	6,782	0.04	0.07	-0.26	0.24
Capex growth ^ω	6,766	0.12	0.44	-0.71	2.11
N of units	6,783	3.06	1.13	2.00	8.00
Dropped units	6,783	0.17	0.54	0.00	6.00
Diversification	6,783	1.81	0.67	1.00	6.44
Firms size	6,783	8.20	1.46	3.79	12.59
TMT Age diversity	4,615	0.11	0.05	0.00	0.45
Operational Cash flow ^ω	6,783	0.09	0.06	-0.06	0.27
Acquisitions ^ω	6,346	0.03	0.06	0.00	0.32
Divestments ^ω	6,783	0.00	-0.04	0.00	0.05

^ω Winsorised at the 1st and 99th percentiles

Research design

As our panel data comprises more than 25 firms ($N > 25$) but fewer than 25 time periods ($T < 25$), we apply the dynamic system GMM method (Raj and Baltagi, 2012). Properly testing the hypothesis required including the lagged dependent variable as a covariate.² This approach is chosen not only because of its effectiveness in addressing endogeneity concerns but also for its capability to eliminate firm-specific heterogeneity effects from the regressions, which are common challenges in other panel data techniques (Arellano and Bond, 1991, Arellano and Bover, 1995, Roodman, 2009). It also conducts two diagnostics tests, such as AR(2) Test and the Hansen Test, to check the consistency and efficiency of the parameters of interest. The results of GMM are valid if these two tests' p -values are insignificant. In addition to implementing the dynamic system GMM method, this study confirms the non-linear association between team-level turnover and capital reallocations through the application of the 'U-shaped' test proposed by Lind and Mehlum (2010). We also revealed the presence of skewness in curves. We achieved that by incorporating cubic and quartic specifications of the

² Including the lagged dependent variable as a covariate is necessary to properly test hypotheses because it helps to account for the potential effects of autocorrelation in the data. Autocorrelation occurs when there is a correlation between successive observations in a time series, which violates the assumption of independence required for many statistical tests. By including the lagged dependent variable as a covariate in the regression model, we can control for the effects of autocorrelation and obtain more accurate estimates of the regression coefficients.

predictor variable. Moreover, to test the robustness of our results, we conduct tests for the S-curve, which helps identify three regimes (Haans et al., 2016).

Endogeneity

Endogeneity occurs for four reasons: omitted variable bias, reverse causality, measurement bias and selection bias (Hill et al., 2021). This study specifically addresses the issue of omitted variable bias, as unobservable endogenous factors within the firm concurrently influence both TMT turnover and asset reallocations. Therefore, we applied the robustness of inference to replacement (RIR) test (Busenbark et al., 2022) to reveal how estimates are likely affected by omitted variable bias. Reverse causality is also plausible to a certain extent; for example, the CEO may replace some members of the TMT (e.g., BU leaders) as part of a reallocation program. The lagged first difference effect in our dynamic panel estimates effectively captures this effect (Hill et al., 2021, Leszczensky and Wolbring, 2022). Across all models, the RIR (relative importance ratio) threshold values were notably high, surpassing the impacts of other observed covariates. This indicates a lower likelihood of omitted variable endogeneity in our analysis.

RESULTS

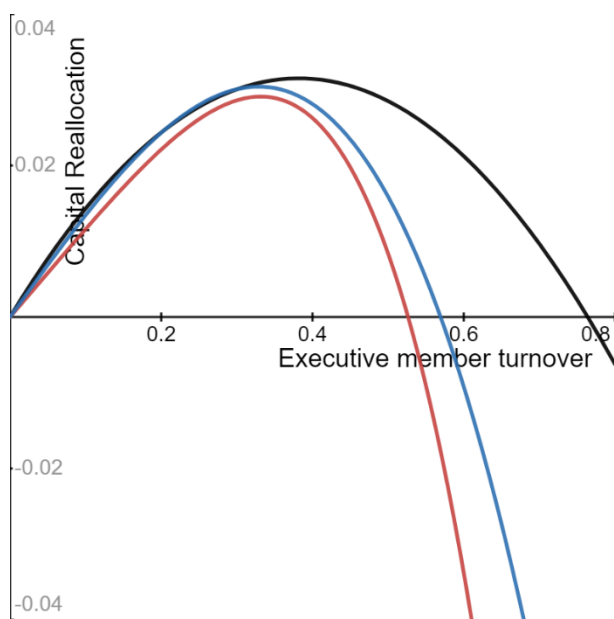


Figure 1 U-shaped effect of member turnover on resource reallocation.

■ Squared specification.
■ Cubic specification.
■ Quartic specification.

The analysis began with the development of a correlation matrix (see Table 5), uncovering no significant effects and a correlation coefficient close to zero. These results hint at a potential non-linear relationship. we conducted regression analysis with the predictors and the dependent variable (see Table 6). In *Model 1*, we regressed only the control variables, while in *Model 2*, we regressed the rate of turnover and its squared term against capital reallocation. In *Model 2* our findings unveiled a positive base coefficient ($b=0.141$, $p<0.01$) and a negative coefficient for the squared term ($b=-0.241$, $p<0.05$), indicating the presence of an inverted U-shaped relationship. To validate our findings, we performed a U-shaped test (Lind and Mehlum,

2010), which supported the existence of this relationship ($p<0.1$). In this test, the significant lower bound (slope = 0.16; $p<0.01$) contrasted with the marginally significant upper bound (slope = -0.2 ;

$p < 0.1$), indicating asymmetry beyond the threshold.³ To address this, we employed skewed U-shape tests with cubic (Model 3) and quartic (Model 4) terms. The RIR test for endogeneity bias revealed that the skewed U-shaped regressions are substantially less biased than squared U-shaped regression.⁴ Additionally, the robustness of our U-shaped model is supported by the S-shaped specifications (Haans et al., 2016). That is, the test did not identify more than two regimes, confirming the U-shape's validity and robustness in our model (*Model 6*). Consequently, we ascertain a slight left skew in the relationship between executive turnover and capital reallocation, as depicted in Figure 1, adopting the quartic specifications as our primary model.

--- Insert Table 6 and 7 here---

In the analysis conducted under *Model 4*, the quartic model estimations revealed a positive coefficient for the first-order member turnover (0.058 to 0.174) and a positive coefficient for the quartic term (−1.254 to −0.351), with both confidence intervals excluding zero. This pattern suggests that member turnover positively influences capital reallocation up to a certain point, after which the impact becomes negative. This threshold, identified at 0.33, is equivalent to a turnover of about five members (or 4.6) in a team of seven over a span of two years. This implies that when team turnover exceeds 66% in two years, the pace of capital reallocation begins to decline, leading to increased allocational inertia.

To confirm the robustness of our findings, we employed separate linear dynamic panel models for team turnovers below and above the threshold of the mean value plus one standard deviation (member turnover < 0.27 and > 0.27 , respectively; refer to Table 7). This analysis revealed a positive linear effect of turnover in the lower regime ($b = 0.105$, $p < 0.01$), contrasting with a negative linear effect in the higher regime ($b = -0.131$, $p < 0.01$). These findings indicate a U-shaped relationship between turnover and the observed outcomes, thereby reinforcing the validity of our initial analysis.

Moreover, the present research underscores a U-shaped association between managerial turnover and capital expenditure growth, identifying a threshold at the 0.24 level (see Table 8). Equivalent to a 48% turnover among team members, surpassing this threshold leads managers to preferentially increase capex. This indicates that at substantial turnover rates, managers tend to decrease relative asset reallocations but substantially increase investment activities. Additionally, the research identifies a U-shaped dynamic concerning divestitures, with a notable threshold of 0.33 (see

³ Squared term assumes symmetry on both sides of the threshold.

⁴ Our model was also compared to both a linear model and models featuring right-skewed U-shapes with square root specifications. These comparisons revealed that the alternative models were not statistically significant or possessed substantially higher biased estimates, affirming the efficacy of our selected model.

Table 8). At this threshold, corresponding to a minimum turnover rate of 66%, there is a significant boost in corporate earnings from divestitures.

--- Insert Table 8 here---

In a supplementary analysis within Model 5 (refer to Table 6), we examined the tenure of the CEO at the time of member replacement but found no significant effects. However, regression analysis indicated that the reasons behind a former CEO's dismissal—specifically, underperformance or misconduct—negatively impact subsequent capital reallocation efforts ($b = -0.0153$; $p < 0.05$). Furthermore, our findings suggest an increase in capital reallocation over time under continuous CEO leadership ($b = 0.0016$; $p < 0.01$). Additionally, certain TMT characteristics were identified as predictors of capital reallocation, including whether the CEO also holds the position of board chairman ($b = -0.022$, $p < 0.01$), the existence of a COO as a distinct role ($b = -0.01$; $p < 0.1$), and the team's size ($b = -0.008$; $p < 0.01$) and age diversity ($b = 0.221$; $p < 0.01$).

DISCUSSION

Our investigation confirms the significant impact of managerial cognition on predicting the direction of corporate capital reallocation. First, we observed that managers tend to maintain inertia in allocations when turnover is minimal, indicating that managers and subordinates are more likely to secure investments when there is no turnover of TMT members. Thus, consistent with popular beliefs, managerial turnover plays a key role in transferring assets between different business segments and departing from old investment patterns. This also aligns with power circulation perspectives, where contenders who take over the majority position in upper echelons are more inclined to redirect the strategies of former or longstanding managers (Ocasio, 1994, Shen and Cannella Jr, 2002, Barron et al., 2011, Zhang et al., 2021). We found that this effect holds true up to a threshold, that is, up to a 66% rate of member turnover.

Surpassing a certain threshold of turnover—specifically, replacing more than 66% of team members—appears to decelerate capital reallocations, an outcome that intriguingly defies the widely held views on path dependence and the dynamics of power circulation. Contrary to expectations that a higher rate of turnover in executive team composition would facilitate swift strategic shifts, this adverse effect of managerial turnover highlights the critical influence of managerial cognition. To address potential confounding factors before attributing this phenomenon to the cognitive nature of managers, we considered the heterogeneity among decision-makers (i.e., team size, age and gender diversity) and conflicts surrounding allocation decisions (N of units and their sizes). We also accounted for the circumstances surrounding the departure of the former CEO, noting that forced departures—

often indicative of underperformance—might prompt new management to enact changes. Our study finds that CEO dismissals exert a more negative influence on capital reallocation decisions compared to other departure scenarios (e.g., retirement, death, illness), possibly due to the ensuing lack of a transition period between old and new teams.

After accounting for various factors, we propose that capital allocation decisions are linked to managerial cognition. Specifically, in scenarios where the majority or the entirety of members responsible for previous investment decisions have been replaced, new managers are more anchored to existing investment patterns when considering investments. Baliga and Ely (2011) argue that new management lacks a comprehensive understanding of the historical sunk costs and decisions associated with the project at the time of planning. Without full awareness of this historical information, executives will search for a reference point to make the next decisions, and existing allocation can serve as a readily available anchoring point. Our findings corroborate this behaviour, demonstrating that firms experiencing high turnover tend to adhere to established allocation patterns. It is important to clarify that this does not imply a mere replication of previous allocations or a succumbing to inertia. Rather, while there is a marked preference among new managers to increase the firm's overall capital expenditures, we show that their decisions are influenced, at least in part, by those established patterns. Thus, preserving approximately 34–35% of the members of previous administrations optimises the effectiveness of capital reallocations. During these peak periods, firms exhibit a 2.9% greater asset reallocation than in scenarios in which there is no or minimal turnover, and a 2% higher reallocation than in scenarios with complete turnover. This observation partially aligns with the findings presented by Boulding et al. (2017) and Long et al. (2020), which advocate for the retention of former decision-makers to enhance both the initiation of projects and the processes for their subsequent re-evaluation.

Others argue behaviours of executives may be influenced by the over-optimistic proposals of subordinates (Brüggen and Luft, 2016). Classical assumptions suggest that new members are often sceptical about proceeding with investments and we do not discount this assumption. Indeed, Brüggen and Luft (2016) research supports this, revealing that while novice executives initially exhibit scepticism towards reinvestments, they can be influenced by the optimistic projections of subordinate managers. Contrasting with these findings, our study suggests that entirely new management teams do not merely perpetuate existing projects. Instead, they are more likely to increase divestment activities, thereby potentially reducing commitments to underperforming ventures. This behaviour aligns with the broader literature that recognises the significance of managerial turnover in facilitating strategic shifts away from underperforming initiatives (see also Chulkov and Barron, 2019, McNamara et al., 2002, Shimizu and Hitt, 2005, Zacharias et al., 2015).

We also further show the profound impact of the CEO's distinctive position on capital allocation within firms. For instance, CEOs who also hold the position of board chairman or who are founders of their companies often display risk-averse tendencies. Such behaviour is associated with a decrease in the overall reallocation of firm resources. Nonetheless, our analysis indicates a positive trend over time, suggesting that CEOs generally enhance the efficiency of capital reallocations as their tenure progresses.

In conclusion, this study examined the extent to which managerial turnover influences deviations from established investment patterns. Consistent with the findings of most studies, our research revealed that the introduction of new executive members often facilitates the reallocation of assets across different units, thereby deviating from previous patterns of inertia. However, our investigation also introduces a nuanced understanding of this dynamic. Specifically, we observed that in scenarios where a majority of the executive team is replaced, new members are biased towards previous investment strategies. This propensity to avoid change can be attributed to their lack of firsthand experience with inherited investments and a lack of understanding of the rationale behind those investments. Consequently, our findings underscore the importance of retaining some former executive members to sustain and enhance dynamic investment strategies.

Table 5 Correlation table

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
(1) Reallocation	1.000																		
(2) Member turnover	0.018	1.000																	
(3) CEO dismissal	-0.006	0.248*	1.000																
(4) CEO tenure	0.051*	-0.171*	-0.104*	1.000															
(5) COO presence	-0.012	-0.048*	-0.037*	0.125*	1.000														
(6) CEO duality	-0.062*	-0.080*	-0.088*	0.212*	0.126*	1.000													
(7) Founder in TMT	-0.015	-0.023	0.038*	0.079*	0.036*	-0.070*	1.000												
(8) Female share	-0.045*	0.070*	0.033*	-0.072*	-0.049*	-0.041*	-0.015	1.000											
(9) TMT size	-0.013	0.253*	0.162*	-0.106*	-0.034*	-0.003	-0.001	0.069*	1.000										
(10) Prior firm performance	-0.099*	-0.137*	-0.150*	0.071*	-0.014	0.061*	0.003	0.006	-0.066*	1.000									
(11) Capex growth	0.044*	-0.076*	-0.069*	0.030*	0.008	-0.028*	0.008	-0.027*	-0.066*	0.097*	1.000								
(12) N of units	0.196*	-0.009	-0.022	0.019	-0.028*	0.076*	-0.061*	-0.013	0.034*	-0.010	-0.035*	1.000							
(13) Units dropped	-0.036*	0.042*	-0.008	-0.003	-0.017	0.030*	-0.004	-0.011	0.033*	-0.019	0.012	0.262*	1.000						
(14) Diversification	0.183*	0.015	-0.005	0.011	-0.044*	0.054*	-0.063*	-0.055*	0.019	-0.009	-0.036*	0.700*	0.173*	1.000					
(15) Firm size	-0.160*	0.035*	0.012	-0.068*	0.032*	0.175*	-0.029*	0.060*	0.147*	0.038*	-0.064*	0.278*	0.063*	0.202*	1.000				
(16) Team age diversity	0.073*	0.054*	0.020	0.182*	0.102*	-0.039*	0.274*	-0.061*	0.017	-0.034*	0.018	-0.069*	0.004	-0.049*	-0.198*	1.000			
(17) Operational cash flow	-0.094*	-0.104*	-0.065*	0.023	-0.016	-0.010	0.008	0.004	-0.094*	0.435*	0.034*	-0.044*	-0.032*	-0.041*	-0.078*	-0.045*	1.000		
(18) Acquisitions	0.082*	-0.020	-0.040*	0.026*	-0.037*	-0.012	-0.004	-0.042*	-0.039*	0.146*	0.128*	0.022	0.088*	0.072*	-0.032*	0.022	-0.017	1.000	
(19) Divestments	0.010	0.013	-0.016	0.028*	-0.015	0.019	-0.007	0.012	0.021	0.060*	0.001	0.004	0.011	-0.005	0.049*	-0.007	-0.002	0.018	1.000

* $p < 0.05$

Table 6 Regression results: Two-step system GMM estimates for member turnover and resource reallocation.

VARIABLES	(1) Controls	(2) Squared U-shaped	(3) Cubic U-shaped	(4) Quartic U-shaped	(5) Interactions	(6) S-shaped specification
Reallocation, $t-1$	0.387*** (0.096)	0.245*** (0.038)	0.248*** (0.036)	0.246*** (0.034)	0.238*** (0.034)	0.158*** (0.025)
Member turnover		0.165*** (0.058)	0.139*** (0.038)	0.117*** (0.029)	0.140*** (0.044)	0.192*** (0.068)
Member turnover ²		-0.216* (0.123)				0.028 (0.316)
Member turnover ³			-0.428*** (0.161)			-0.751* (0.416)
Member turnover ⁴				-0.802*** (0.230)	-0.884*** (0.238)	
CEO tenure $\times$ Member turnover					-0.004 (0.004)	
CEO dismissal	-0.007 (0.012)	-0.011 (0.008)	-0.013* (0.007)	-0.015** (0.007)	-0.014* (0.007)	-0.004 (0.006)
CEO tenure	0.001 (0.000)	0.001*** (0.000)	0.001*** (0.000)	0.001*** (0.000)	0.002** (0.000)	0.001*** (0.000)
COO presence	-0.012* (0.006)	-0.011** (0.005)	-0.010* (0.005)	-0.010* (0.005)	-0.010** (0.005)	-0.011** (0.004)
CEO duality	-0.028*** (0.009)	-0.023*** (0.006)	-0.023*** (0.006)	-0.022*** (0.006)	-0.022*** (0.006)	-0.029*** (0.005)
Founder in TMT	-0.038** (0.019)	-0.038*** (0.014)	-0.042*** (0.014)	-0.043*** (0.014)	-0.043*** (0.015)	-0.041*** (0.0128)
Female share	0.005 (0.033)	0.013 (0.022)	0.0123 (0.021)	0.008 (0.020)	0.007 (0.020)	0.025 (0.016)
Team size	-0.010** (0.004)	-0.010*** (0.003)	-0.009*** (0.003)	-0.008*** (0.003)	-0.008*** (0.003)	-0.013*** (0.002)
Firm performance, $t-1$	-0.088 (0.059)	-0.102*** (0.038)	-0.094** (0.038)	-0.081** (0.037)	-0.079** (0.036)	-0.080** (0.031)
Capex growth	0.024*** (0.008)	0.029*** (0.005)	0.030*** (0.005)	0.030*** (0.005)	0.031*** (0.005)	0.030*** (0.004)
N of units	0.015* (0.009)	0.018*** (0.006)	0.0174*** (0.005)	0.017*** (0.005)	0.017*** (0.005)	0.021*** (0.004)
Units dropped	-0.039*** (0.005)	-0.039*** (0.004)	-0.039*** (0.004)	-0.040*** (0.004)	-0.039*** (0.004)	-0.041*** (0.003)
Diversification	0.022 (0.015)	0.030*** (0.010)	0.031*** (0.009)	0.032*** (0.009)	0.033*** (0.009)	0.033*** (0.007)
Firm size	0.009 (0.009)	0.006 (0.005)	0.005 (0.005)	0.003 (0.005)	0.003 (0.005)	0.006 (0.004)
Age heterogeneity	0.264*** (0.065)	0.239*** (0.049)	0.232*** (0.049)	0.221*** (0.049)	0.224*** (0.049)	0.230*** (0.040)
Operational cash flow	-0.0853 (0.082)	-0.066 (0.054)	-0.063 (0.054)	-0.071 (0.054)	-0.088* (0.053)	-0.118*** (0.041)
Acquisitions	0.226*** (0.056)	0.188*** (0.038)	0.185*** (0.038)	0.182*** (0.037)	0.182*** (0.037)	0.134*** (0.031)
Constant	0.047 (0.074)	0.040 (0.046)	0.042 (0.046)	0.052 (0.045)	0.052 (0.045)	0.061 (0.039)
<i>Model specifications</i>						
Wald χ^2	104.65***	143.50***	143.93***	144.16***	138.11***	178.75***
AR (2) Test (p -value)	0.153	0.304	0.292	0.302	0.334	0.788
Hansen test (p -value)	0.632	0.787	0.724	0.615	0.613	0.706
Number of instruments	75	197	197	197	198	258
RIR test		30%	46%	50%	38%	30%
Observations	3,970	3,970	3,970	3,970	3,970	3,970
Number of firms	522	522	522	522	522	522

Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

To control instrument proliferation, we added only three lags for the dependent variable, i.e., $t_{(-2)} - t_{(-4)}$; no more than 4 lags for the predictors.

Table 7 Regression results: Two-step system GMM estimates for two different regimes of member turnover.

VARIABLES	(1)	(2)
	Lower Member turnover (< sample mean +1SD)	High Member turnover (> sample mean + 1SD)
Reallocation, $t-1$	0.147*** (0.017)	0.149*** (0.024)
Members turnover	0.105*** (0.040)	-0.131*** (0.034)
CEO dismissal	-0.018 (0.012)	-0.008 (0.013)
CEO tenure	0.001** (0.000)	-0.000 (0.000)
COO presence	-0.010 (0.007)	0.011 (0.011)
CEO duality	-0.026*** (0.008)	-0.015 (0.011)
Founder in TMT	-0.023 (0.018)	-0.076*** (0.020)
Female share	0.032 (0.028)	-0.004 (0.036)
Team size	-0.010** (0.004)	-0.002 (0.004)
Firm performance, $t-1$	-0.157*** (0.052)	0.147** (0.062)
Capex growth	0.021*** (0.006)	0.025** (0.010)
N of units	0.014* (0.008)	0.017* (0.010)
Units dropped	-0.039*** (0.005)	-0.028*** (0.007)
Diversification	0.041*** (0.013)	0.030** (0.014)
Firm size	0.001 (0.008)	-0.024*** (0.009)
Age heterogeneity	0.164*** (0.057)	0.405*** (0.114)
Operational cash flow	-0.144* (0.075)	-0.181* (0.095)
Acquisitions	0.218*** (0.044)	0.094 (0.064)
Constant	0.108* (0.059)	0.266*** (0.078)
<i>Model specifications</i>		
Wald χ^2	114.16***	205.47***
AR (2) Test (p -value)	0.822	0.213
Hansen test (p -value)	0.277	0.457
Number of instruments	152	139
RIR test	24%	50%
Observations	3,269	701
Number of firms	496	318

Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

To control instrument proliferation, we added only four lags for the dependent variable, i.e., $t_{(-2)} - t_{(-5)}$; no more than four lags for the predictors.

Table 8 Regression results: Two-step system GMM estimates for capex growth and earnings from divestments.

VARIABLES	(1) Capex growth	(2) Divestments
Dependent variable, $t-1$	0.080** (0.033)	-0.030*** (0.009)
Members turnover	-0.327*** (0.108)	-0.002*** (0.000)
Members turnover ³		0.008** (0.004)
Members turnover ⁴	3.498*** (1.058)	
CEO dismissal	-0.122*** (0.024)	-0.000 (0.000)
CEO tenure	0.001 (0.000)	-0.000*** (0.000)
COO presence	0.007 (0.008)	-0.000*** (0.000)
CEO duality	-0.033*** (0.008)	0.000** (0.000)
Founder in TMT	-0.000 (0.031)	-0.000 (0.000)
Female share	-0.002 (0.045)	-0.000 (0.000)
Team size	-0.004 (0.006)	0.000*** (0.000)
Firm performance, $t-1$	0.213** (0.104)	0.003*** (0.000)
N of units	0.002 (0.004)	-0.000 (0.000)
Units dropped	0.001 (0.008)	0.000** (0.000)
Diversification	-0.006 (0.006)	0.000* (0.000)
Firm size	-0.012*** (0.002)	-0.000*** (0.000)
Age heterogeneity	0.055 (0.129)	-0.003** (0.001)
Operational cash flow	0.142 (0.140)	-0.009*** (0.001)
Constant	0.186*** (0.043)	0.001 (0.000)
<i>Model specifications</i>		
Wald χ^2	63.29***	8.31***
AR (2) Test (p -value)	0.587	0.647
Hansen test (p -value)	0.308	0.483
Number of instruments	201	195
RIR test	35%	37%
Observations	4,208	4,212
Number of firms	531	531

Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

To control instrument proliferation, no more than four lags for the dependent variable, i.e., $t_{(-2)} - t_{(-5)}$;
No more than 4 lags for the predictors.

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