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## Does familiarity with business segments affect CEOs' divestment decisions? ☆



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### ABSTRACT

We examine the impact of familiarity with business segments on CEOs' divestment decisions. We find CEOs are less likely to divest assets from familiar than from non-familiar segments. We attribute this effect to CEOs' comparative information advantage with respect to familiar segments. Consistent with this information advantage, we document that the familiarity effect is particularly strong in R&D intensive industries. We further find the familiarity effect to be most pronounced for longer-tenured CEOs who have built up sufficient political power over the course of several years in office to enable implementation of their preferred divestment choices. We also document the value effects of divestments and show that familiarity affects returns on divestment announcements.

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### 1. Introduction

Corporate divestment decisions can be major business restructurings. In this paper, we examine whether CEOs' career paths affect their divestment decisions. Recent research in corporate finance has found that managerial characteristics play an important role in investment, financial, and strategic decisions (e.g., Bertrand and Schoar, 2003; Chang et al., 2010; Malmendier and Tate, 2005, 2008), and substantial empirical evidence documents investors' and managers' preference for choosing the familiar. Investors, for example, are inclined to ignore optimal portfolio principles in order to invest in familiar companies (see, for example, French and Poterba, 1991; Huberman, 2001; Li, 2004; Parwada, 2008). Firms exhibit a similar geographic proximity effect in both cross-listing decisions (Sarkissian and Schill, 2004) and banking choices (Berger et al., 2003).

In this paper, we attempt to determine whether multi-segment firms' divestment decisions are affected by CEOs' familiarity with the firms' segments. Consider a firm that operates in two business segments, segment A and segment B. The CEO is familiar with segment A, having previously been employed in that segment, but not with segment B. Faced with an opportunity to divest assets from either segment, which one will the CEO choose? We propose two non-mutually exclusive hypotheses: one that is based on CEOs' better information about familiar segments and the other on the CEOs' political power in a firm.

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The first hypothesis, labeled the *comparative information hypothesis*, predicts that CEOs are less likely to divest assets from segments familiar to them. The intuition behind this hypothesis is that CEOs' previous work experience with the segment provides a comparative information advantage with respect to the familiar relative to non-familiar segments. CEOs prefer to manage familiar segments, because their better understanding of a segment's business enhances confidence in assessments of the quality of investment opportunities (Miao and Sandford, 2013). Due to agency problems between CEOs and division managers,<sup>1</sup> CEOs' information advantage with respect to familiar segments can affect firms' budget allocations. Divestments in this setting can be viewed as negative budget allocations in the internal capital markets in which CEOs often rely on segment managers' private information about future cash flows. Because segment managers are prone to overstate their case in order to secure a greater allocation of the budget or to avoid divestment, CEOs discount the requests of segment managers who possess more private information (Bernardo et al., 2001; Harris and Raviv, 1996, 1998). This is the case for segments with which a CEO is not familiar.

We postulate that the familiarity effect may change over the years following the appointment of a CEO. On the one hand, the immediate usefulness of the information gained from the experience of managers in a familiar segment could diminish over time. On the other hand, we have two reasons to expect a persistence of this information advantage: (1) CEOs' comparative information advantage can stem from a profound and deep knowledge of familiar segments, e.g., having the common technical training to grasp the essence of new developments, and (2) CEOs are more able to share information with the current managers of familiar segments that would reduce CEOs' costs of information acquisition and verification. Having a common background (Gaspar and Massa, 2011) and being connected (Duchin and Sosyura, 2013) foster more personal interaction and a higher level of trust. As a result, more information will be shared with managers of segments that CEOs share a common background with and to whom they are connected, and more capital may be allocated to them too. In our setting, CEOs and managers of familiar segments have worked in the same segment and, if they did so during the same time period, are likely to be connected. Their common background leads them to keep each other informed about segment-related developments, and the mutual trust they share to keep such exchanges truthful. In the case of persistence of CEOs' comparative information advantage over familiar segments, we expect CEOs' preference for divesting non-familiar segments to last over the course of their tenure.

The second hypothesis, which we term the *political power hypothesis*, predicts that the preference for divesting non-familiar segments is contingent on CEOs commanding sufficient political power to carry out their preferred choices. The internal capital market's capital allocation processes in multi-division firms can be disrupted by segment managers with bargaining power derived from valuable private information and internal political clout (Stein, 2003). The bargaining power of managers of non-familiar segments results from CEOs' dependence on such managers' valuable knowledge and political support. Xuan (2009) argues that susceptibility to the bargaining power of managers of non-familiar segments is strongest among CEOs new to the job, and thus particularly for new CEOs who have not yet accumulated sufficient internal political capital before their promotion to the CEO position. He provides evidence that such CEOs find it expedient to promote goodwill towards managers of non-familiar segments by increasing their investment allocation. Divestments can be viewed as the mirror image of investments, where CEOs decide to divest a full segment or a part of it. Especially in the case of partial divestments (which encompasses 88 percent of our sample of divesting segments), CEOs' relationship with segment managers remains important after the divestment. We therefore expect the motivation to build political capital with managers to lead new CEOs to refrain from divesting assets from non-familiar segments until they have accumulated sufficient political power to act according to their preferences.

Our analysis yields evidence consistent with both hypotheses. In line with the comparative information hypothesis, we find that CEOs divest familiar segments 39% less often than non-familiar segments. Consistent with the political power hypothesis, we observe the familiarity effect predominantly in the subsample of established (i.e., with tenure of three years or more) over newly hired CEOs. We refine the political power test using subsets of newly hired CEOs that had a head-start in acquiring political power as chief operating officer (COO). We find less powerful new CEOs to act contrary to their preference in being *more* likely to divest assets from familiar segments. This finding complements Xuan's (2009) conclusion that less powerful new CEOs attempt to build rapport with their managers by increasing capital allocations to non-familiar segments. We do not observe this behavior among more powerful new CEOs.

We define familiar segments as segments in which CEOs worked before being promoted to their current positions (also referred to as direct-experience segments). To provide additional evidence for the comparative information hypothesis, we extend the scope of familiarity to include industry experience within the firm. Segments familiar by virtue of CEO experience in another segment operating in the same industry as the direct-experience segment (referred to as industry-experience segments) are the basis of a shared background with the managers of segments about which CEOs are knowledgeable, albeit not as knowledgeable as about their direct-experience segments. If superior information plays an important role in selecting segments to be divested, CEOs with sufficient internal political clout may also be reluctant to divest assets from industry-experience segments. Our results support this conjecture. Although the familiarity effect is stronger for direct-experience than for industry-experience segments, we find established CEOs to be less likely to divest assets from the latter than from non-familiar segments.

Our second additional test of the comparative information hypothesis is based on the depth of knowledge. Information asymmetry between the CEOs and the segments is expected to be greatest for high R&D intensive segments, because R&D investments are based on soft information that is typically difficult to transmit in an impersonal way.<sup>2</sup> They also tend to be uncertain and difficult to accurately assess (Miao and Sandford, 2013). Since the trust and confidence that the CEOs establish between familiar segments can

<sup>1</sup> See for instance Milgrom and Roberts (1988), Jensen (2003), and Wulf (2009).

<sup>2</sup> See Petersen (2004) for a discussion of the use of hard and soft information.

help alleviate the information asymmetry, we expect the familiarity effect to be most pronounced for familiar segments that operate in R&D intensive industries. Our findings are in line with this conjecture.

Our final analysis is an event study around divestment announcements to measure the valuation effects of familiarity. Consistent with their superior information with respect to direct-experience segments, we find CEOs' divestments of these segments to generate 1.2% higher abnormal returns. The greater returns are particularly pronounced for divestments of direct-experience segments by the more powerful CEOs, i.e., the longer-tenured CEOs.

The familiarity effect on divestment decisions holds against four alternate explanations. We first test the explanation that boards select CEOs with work experience specific to a business segment that is to be grown and focused upon as part of firm strategy. The effects of the board's mandates to grow direct-experience segments should be particularly strong in a CEO's first years of tenure; instead, it is the subset for which we do not find a familiarity effect. We further find that in the year prior to CEO appointment, the *ex ante* predicted probability of divesting assets is higher for direct-experience segments relative to other segments. We consider a second explanation that is based on selection. That is, internal promotion criteria favor CEOs from superior performing segments, which should also be the segments that are least likely to be divested. In that case, we expect (1) the familiarity effect to be observed most frequently early in a CEO's tenure, (2) direct-experience segments of firms managed by new CEOs to outperform non-familiar segments, and (3) the *ex ante* predicted probability of a segment being divested to be higher. We find no evidence to support any of these expectations. The third alternate explanation for the familiarity effect is CEO entrenchment (Shleifer and Vishny, 1989). Here, CEOs would divest assets from non-familiar segments to increase the proportion of assets that complement their skills. Accounting for governance mechanisms, we find no support for this explanation. Fourth, if a CEO's direct experience in a segment were to proxy for the segment being a core business, i.e., CEO are more likely to be selected from core business, our documented familiarity effect might merely reflect a firm's decision to focus on its core business. Our finding that CEOs tend to be particularly reluctant to divest assets from non-core direct-experience segments contradicts this explanation.

Our main contribution in this paper is to demonstrate significant effects of CEOs' professional career paths on corporate strategy and value. We show that divestment decisions in a multi-segment firm depend on two factors: the CEO's familiarity with a segment affords her the knowledge that would result in less severe discounting of the segment manager's claims, and the possession of adequate political clout with top managers.

Our paper adds to the stream of literature on capital allocation decisions (see Maksimovic and Philips, 2007; Stein, 2003). Furthermore, Weisbach's (1995) classic paper argues that CEOs are least likely, shortly after being appointed, to divest assets that represent their skill sets. This paper differs from ours in that Weisbach (1995) does not directly examine CEO characteristics; the divestments in his sample are all assets acquired under previous CEOs and he focuses on newly appointed CEOs.<sup>3</sup> The study most directly related to ours is Xuan (2009), which yields parallel results in its finding that new CEOs favor non-familiar segments during their first two years of tenure. Extending our analysis beyond two years reveals CEOs' preference for familiar segments to be manifested when they become more established. Another related paper, Huang (2010), suggests that CEOs attempt to improve firm performance by divesting entire segments that operate in industries in which they lack work experience in pursuit of a better match between their skill set and new firm. We posit two interpretations of skill set, one being the skills to operate a segment, the other the skill or knowledge requisite to more deeply understanding a segment's value and potential. Although both papers examine a familiarity effect, our hypothesis is developed on a more comprehensive foundation that takes into account the application of superior information to divestment decisions under the political power constraint.

Our paper also contributes to studies of executive career paths that distinguish between generalist and specialist CEOs. Murphy and Zbojnik (2004), for example, find general management skills to be more important than firm-specific experience and skills as a determinant of CEO pay. Because bargaining power in the labor market may explain this effect, Custódio et al. (2013) investigate the composition of CEOs' general skills, and document a trend towards more generalist CEOs who earn a premium in pay, particularly during restructurings and acquisitions. A CEO familiar with a particular segment can be both a specialist and a generalist, which engenders the interesting question of whether our result is stronger for either type of CEO. Exploring this question in the case of divestment decisions, we find no difference in the familiarity effect between generalist and specialist CEOs.

Finally, our findings complements the paper of Landier et al. (2009), who examine the effect on corporate decisions of geographic location, specifically, the proximity of a segment to its headquarters (specifically, whether a segment and headquarters are in the same state). Our study measures social distance as CEOs' personal ties to segments. Landier et al. (2009) finding that CEOs are less likely to divest divisions and lay off employees of divisions more proximate to headquarters, and that information constraints explain why CEOs favor more proximate employees, complements our information explanation.

The paper is organized as follows. In Section 2, we outline the set-up of our empirical analysis. Results of our tests of the comparative information and political power hypotheses are presented in Section 3. We investigate three alternative explanations of the familiarity effect in Section 4, and describe the valuation effects of familiarity in Section 5. Section 6 concludes.

<sup>3</sup> In a recent paper, Pan et al. (2013) show that CEOs have a tendency to concentrate divestments in the early phases of their tenure and have relatively few divestments afterwards to focus on investment and growth. These authors conclude that CEO power in the board room is a key determinant of this pattern. While our analysis is conditional on the choice to divest assets, we add to a further understanding of the nature of the divested assets.

## 2. Data sources and methods

### 2.1. Sample and data sources

We construct our initial sample from the Compustat Business Information File and Securities Data Corporation (SDC) file. We select data for firms with at least two business (or operating) segments for our sample period of 1996–2004. As in Schlingemann et al. (2002), we select firms with sales in excess of \$20 million or assets exceeding \$100 million. We exclude American Depository Receipts (ADRs) and firms not incorporated in the United States as well as firm years with segments that operate in regulated industries (SIC 4900–4999). Like Berger and Ofek (1995) and Schlingemann et al. (2002), we require that the sum of segment sales not deviate more than 1% from total firm sales. These selection criteria result in a sample of 5251 firm years for 1009 firms for our sample period.

Selecting from the SDC database for all divestments completed during the 1996–2004 period by the 1009 multi-segment firms yields 1317 firm years (530 firms) with divestments. Similar to Xuan (2009, p. 4921), we measure divestments at the level of segments and use the terms segment and division interchangeably. Segments or divisions may consist of several business units, and firms can divest an entire division or one or more business units. We require that more than 95% of a unit's assets be acquired by the buying firm post transaction (as in McNeil and Moore, 2005). We manually link divested business units with the business segments reported in Compustat using the SDC divestment synopses, SDC SIC codes, and SDC business descriptions of divested assets. Additionally, we search SEC 10-K filings for descriptions of segments and discontinued operations. The unit of observation in our main analysis is a segment in a given year. We treat multiple divestments within one segment year as a single segment observation.<sup>4</sup>

We require segments to have at least two years of data prior to divestment. During our sample period, which includes the introduction of SFAS 131 in 1997, several firms changed their segment reporting (see Berger and Hann, 2003, 2007).<sup>5</sup> Compustat provides revised historical financial information for new segments for the two years prior to reporting based on firms' annual reports. We exclude 589 firm years from 192 firms due to incomplete Compustat historical data.

We require for our familiarity variables detailed information about CEOs' work experience, for which we turn to summaries of top executives' current and past positions in the Marquis Who's Who and Hoover's databases. We focus on the segments within CEOs' firms to measure experience and do not distinguish levels of previous positions. For CEOs whose careers we cannot reconstruct from these sources, we consult SEC 10-K and proxy filings. In the event these sources lack sufficient data, we exclude the observation (we exclude 49 firm years for 21 firms). We acknowledge that, owing to the imperfection of these sources, we may miss an executive's prior experience. However, this would lead to a bias against finding economically and statistically significant effects for variables based on experience. We exclude as well 71 firm years (15 firms) for reasons of firms having two CEOs, classifications of divestments being ambiguous, or divestments occurring in corporate segments in which firms divested assets acquired from a merger in the previous year. This selection procedure yields 608 firm years with 2394 segment years. Finally, we exclude 393 segment years with incomplete corporate financial information or that are tagged as "elimination" (as in Lamont, 1997). In total our sample contains 2001 segment years.

We are interested in whether familiarity with segments affects CEOs' selections of which segment to divest. A preference for one segment over another based on familiarity can be exhibited only when a CEO has a choice between familiar and non-familiar segments, which is to say, when levels of familiarity differ within a firm year. We therefore exclude 342 firm years in which CEOs lack direct work experience in any segment (the case of external CEOs, who by definition cannot have direct work experience in a segment) or only have experience overseeing all segments (as the case of founders).<sup>6</sup> Our final sample includes 923 segment years (352 of which experience a divestment and 571 of which are fully retained), 266 firm years, 121 firms, and 134 CEOs.

### 2.2. Familiarity measure

We construct at the segment level two proxy variables for familiarity that differentiate the two levels of relevant work experience prior to being appointed CEO. Because understanding our measures is crucial to our analysis, we illustrate the definitions with an example. In fiscal year 1998, Bausch & Lomb disclosed four segments: Vision Care (two-digit SIC 28 and 38), Eyewear (two-digit SIC 38), Pharmaceuticals (two-digit SIC 28), and Healthcare (two-digit SIC 2 and 28). William Carpenter, Bausch & Lomb Inc.'s CEO in 1998, had been a global business manager in the company's Eyewear segment from the time when he joined the firm in March 1995 until December 1995.

Our first measure, the strongest form of familiarity, is direct work experience within a segment. We classify Bausch & Lomb's Eyewear segment, of which Carpenter was global business manager, as the segment in which he has direct work experience. This level of familiarity implies knowledge of a segment's industry and internal operations as well as direct personal relations with its personnel and management.

<sup>4</sup> If multiple divestments occur in different segments, we classify more than one segment within one firm year as a divesting segment.

<sup>5</sup> Under SFAS 131 firms do not always report segments based on industry; they can also report their segments based on vertical integration. We believe that this change in segment reporting does not affect our conclusions. If anything, it would add noise to our analyses, and hence work against finding significant results.

<sup>6</sup> The 342 excluded firm years consist of 61 firm years with founders (including CEOs who started as executive officers subsequent to a spin-off), 136 firm years with external hires (who cannot have direct-experience segments), 14 firm years with internal hires and all segments direct-experience segments, and 131 firm years with internal hires without any familiar segments. Instead of deleting those firm years, we could add an interaction term between firm years with variation in familiarity and the different familiarity measures and use the entire sample of 608 firms. Our conclusions hold when we repeat the analysis. However, because we use logit regressions for which the interpretation of interaction coefficients is not trivial (e.g., Ai and Norton, 2003), we decided to exclude those 342 observations from our analyses.

Industry work experience refers to experience gained working in a segment that operated in the same two-digit SIC industry as the reported segment. In our example, industry work experience in the Vision Care segment is attributed to Carpenter because it operates in the same two-digit industry (SIC 38) as the Eyewear segment of which he was global business manager.

Industry work experience is inferior to direct work experience in terms of the level of familiarity, because it implies a lower likelihood of having personal connections and specific knowledge of assets, procedures, and developments within reported segments. We term “non-familiar segments” as those in which CEOs have neither direct nor industry work experience. We treat classifications of CEO familiarity with individual segments as mutually exclusive, where the segments are assigned to the stronger of the two forms of familiarity. In our example we classify Eyewear as a direct work experience segment, Vision Care as an industry work experience segment, and Pharmaceuticals and Healthcare as non-familiar segments.

### 2.3. Control variables

To examine the type of segment selected for divestment, we include a number of control variables. For each business segment we obtain from the Compustat Business Information File sales, assets, net capital expenditures (calculated as gross capital expenditures minus depreciation and amortization), cash flows (calculated as operating profit plus depreciation and amortization), and primary and secondary SIC codes,<sup>7</sup> and from the Annual Compustat File, segment industry-adjusted measures and variables for calculating Tobin's  $q$  as well as firm-level financial variables and primary SIC code. We obtain governance information from the IRRC and share price information from CRSP.

We classify as core the largest segment in a firm in terms of reported sales that has the same primary two-digit SIC code as the firm. To facilitate comparability, we follow Schlingemann et al. (2002) in calculating industry measures as the median of all Compustat firms with the same two-digit SIC code in the fiscal year prior to the divestment announcement. To ensure reliability, we require that at least five firms operate in the same industry. A segment's Tobin's  $q$  is the industry ratio of the market value of assets to the book value of assets, for which we use variables similar to those employed by Malmendier and Tate (2005, 2008).<sup>8</sup> We use SALE to calculate median industry sales, OIBDP to calculate median industry cash flows, and CAPX and DP to calculate median industry net capital expenditures. We follow Ahn and Denis (2004) in estimating cross-subsidization as segments' industry-adjusted investment minus their firms' sales weighted sum of industry-adjusted investment, and Schlingemann et al. (2002) in calculating segment liquidity by dividing the total value of acquisition transactions by an industry's total assets, excluding from the sample values higher than one and industries with fewer than ten firms. We calculate a segment's industry R&D intensity as the R&D expenditures of all Compustat single-segment firms with the same two-digit SIC code weighted by the firms' beginning of year total assets. This measure requires that at least five firms operate in the same industry. We code missing values of R&D as zero (removing these observations from our calculations does not alter our findings).

At the firm level, we calculate leverage as total debt (LT) divided by total assets (AT).<sup>9</sup> A firm's Tobin's  $q$  is the market to book value of assets, for which we use the same variables as the segment's Tobin's  $q$ . We calculate net capital expenditures as gross capital expenditures (CAPX) minus depreciation and amortization (DP), and use CHE for cash and short-term equivalents.

Following Berger and Ofek (1995), we calculate excess value as the percentage difference between a firm's total value and the sum of imputed values of its segments as stand-alone firms. We define excess value as equal to  $\ln(V/I(V))$ , where  $V$  is total firm value calculated as the market value of equity (PRCC \* CSHO) plus book value of debt (LT), and  $I(V)$  the imputed value of the sum of a firm's segments as stand-alone firms,

$$I(V) = \sum_{i=1}^n A_i * (Ind_i(V/AI)_{mf}), \quad (1)$$

where  $A_i$  is segment  $i$ 's sales,  $n$  the number of segments, and  $Ind_i(V/AI)_{mf}$  the multiple of total capital to sales for the median single-segment firm with at least \$20 million in sales in segment  $i$ 's industry. We follow Berger and Ofek (1995) and Schlingemann et al. (2002) in basing industry median ratios on the narrowest SIC grouping with at least five firms in an industry, and excluding from our sample, and considering as outliers, any values larger than 1.386 or smaller than -1.386.

Following Rajan et al. (2000) and Schlingemann et al. (2002), we calculate a firm's diversity in  $q$  as

$$Diversity = \sqrt{\sum_{i=1}^n (Sales_i / \sum_{i=1}^n Sales_i) \times (q_i - \bar{q})^2 / \bar{q}}, \quad (2)$$

where  $Sales_i$  refers to segment  $i$ 's sales,  $n$  to the number of segments,  $q_i$  to the median  $q$  of all Compustat firms with the same two-digit SIC code as segment  $i$ , and  $\bar{q}$  to the sales-weighted average imputed  $q$  across the  $n$  segments of the firm. We use as a score for anti-shareholder charter provisions the entrenchment index constructed by Bebchuk et al. (2009). The percentage of independent directors is the number of independent directors divided by the total number of directors.

<sup>7</sup> We follow the recommendation of Kahle and Walking (1996) in using Compustat's industry classification and not that of CRSP, and using the historical industry classifications throughout our analyses.

<sup>8</sup> We calculate the market value of assets as book value of total assets (AT) plus market equity minus book equity. Market equity = (CSHO \* PRCC), book equity = (SEQ - PSTKL + TXDITC - PPROR).

<sup>9</sup> Our sample contains 15 observations in which the firm's leverage exceeds one, which is theoretically not possible. We set these values to one. Not setting these observations to one does not alter our results.

We estimate abnormal returns to divestment announcements using the market model as described by MacKinlay (1997). Our estimation window runs from day  $-160$  to day  $-41$  relative to the announcement date. We aggregate abnormal returns over the day prior to until the day after the divestment announcement.

## 2.4. Summary statistics

Table 1 provides the statistics for our sample of divesting firm years.

We present first the firm statistics. The sample firms have average sales of nearly \$11 billion and average assets of approximately \$14 billion. Leverage is relatively high (65%), which may be a consequence of selecting divesting firm years. Our average sample firm performs well, with positive cash flows prior to the divestment year and an average Tobin's  $q$  of 1.877. The average number of segments in which the firms operate is 3.47, and the average diversity in  $q$  across segments is 0.118. Our sample of divesting firm years' positive average excess value of 0.105 indicates that the average firm in our sample does not underperform its single-segment counterparts. The entrenchment index ranges from zero to five, with an average of 2.417, and our sample firms have, on average, 67.1% independent directors.

Panel B reports divestment statistics at the firm year level. With an annual average of 1.323, the average divesting firm in our sample divests assets from more than one segment in a year. Only 15.4% of our divesting sample firms divests one or two full segments. Aggregating the deal value of all divested business units within a firm year, we find the value of the divested assets, on average \$534 million, to account for 10.8% of our sample firms' total assets.

Panel C reports CEO specific statistics. Because testing the comparative and political power hypotheses requires that all CEOs have a direct experience segment, our sample consists only of internally hired CEOs who have direct work experience in one or more segments in a firm year. We find 59.8% of CEOs to have industry-experience segments, average CEO age to be 56, and average term of employment with a firm to be 23.8 years and tenure as CEO of 5.5 years. We further find CEOs to hold on average two titles (e.g., president as well as CEO), and 61.2% of all CEOs held the corporate executive title of COO before being promoted to their CEO position.

Table 2 reports, in Panel A, statistics for familiar and non-familiar segments, and, in Panel B, statistics for divested versus fully retained segments.

**Table 1**

Firm and CEO summary statistics.

The table shows the means, standard deviations, minimum and maximum values, and number of observations of firm, divestment, and CEO variables. Leverage is debt divided by total assets. Net capital expenditures are gross capital expenditures minus depreciation and amortization. We define cash flows as operating profit plus depreciation and amortization. Tobin's  $q$  is the ratio of the market-to-book value of assets as calculated in Malmendier and Tate (2005, 2008). We calculate the excess value measure as in Berger and Ofek (1995), diversity in  $q$  as in Rajan et al. (2000), and the entrenchment index as in Bebchuk et al. (2009). We define independent directors as the percentage of independent directors relative to all directors. Fully divested segments are segments that are completely divested and cease to be reported by firms post divestment. The aggregate transaction value is the sum of the transaction values of all divested business units within a firm year (we require firms to report the transaction value of at least one divestment within a firm year). Direct-experience segments are segments in which a CEO worked prior to appointment as CEO. Industry-experience segments are segments that operate in the same two-digit SIC industry as the direct-experience segments.

	Mean	SD.	Minimum	Maximum	N
<i>Panel A. Firm summary statistics</i>					
Sales <sub>t-1</sub> (\$M)	10,641	18,508	141	153,627	266
Assets <sub>t-1</sub> (\$M)	13,977	33,274	175	279,097	266
Leverage	0.646	0.143	0.251	1.000	266
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	0.013	0.057	-0.228	0.457	266
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.193	0.099	-0.051	0.859	266
Tobin's $q$	1.877	1.059	0.241	7.302	266
Number of business segments	3.470	1.172	2.000	7.000	266
Diversity in $q$	0.118	0.116	0.000	0.492	258
Excess value	0.105	0.486	-1.386	1.386	244
Entrenchment index	2.417	1.410	0	5	266
Independent directors	0.671	0.156	0.222	0.917	255
<i>Panel B. Divestment statistics</i>					
Number of segments with a divestment	1.323	0.577	1	4	266
Dummy for firm years with a fully divested segment	0.154	0.362	0	1	266
Number of segments with a fully divested segment	0.158	0.376	0	2	266
Aggregate transaction value of all divested business units (\$M)	534	1037	1	7500	177
Aggregate transaction value of all divested business units/assets <sub>t-1</sub>	0.108	0.205	0	1.402	177
<i>Panel C. CEO summary statistics</i>					
Number of direct experience segments	1.331	0.605	1	4	266
Dummy for firm years with industry-experience segments	0.598	0.491	0	1	266
Number of industry-experience segments	0.880	0.928	0	5	266
Years employed as CEO	5.523	5.463	0	30	266
Years worked for firm	23.802	10.117	2	47	258
Number of titles (CEO, president, chairman)	2.158	0.489	1	3	247
CEO age	56.342	6.121	40	74	266

**Table 2**

Characteristics of subsamples.

This table presents means, standard deviations, number of observations, and mean differences for segments in the fiscal year prior to the divestment announcement. Panel A compares familiar and non-familiar segments, Panel B segments CEOs decide to divest and fully retain. Proxies for familiarity are CEO direct-experience and industry-experience segments. Relative size equals segment sales divided by firm sales. The size < 10% dummy indicates that segment sales are less than 10% of firm sales. The core segment dummy equals one for the largest segments within a firm year, based on sales, with the same primary two-digit SIC code as the primary two-digit SIC code of the firm. Cash flows are segments' operating profit plus depreciation and amortization. Net capital expenditures are gross capital expenditures minus depreciation and amortization. We define the cross-subsidization variable as in [Ahn and Denis \(2004\)](#). A segment's Tobin's  $q$  represents the median industry  $q$  of all Compustat firms with the same two-digit SIC code as the segment ( $q$  is the ratio of the market-to-book value of assets, as calculated in [Malmendier and Tate, 2005, 2008](#)). Segment industry liquidity is the liquidity index at the two-digit SIC code level, as calculated in [Schlingemann et al. \(2002\)](#). Segment industry R&D to assets equals R&D expenditures of all Compustat single-segment firms with the same two-digit SIC code by the firms' beginning of year total assets. We code missing values of R&D as zero. We define industry-adjusted variables as the segment variable minus the median of all Compustat firms with the same two-digit SIC code. Fully divested segments are segments that are completely divested and cease to be reported by firms post divestment. Aggregate transaction value is the sum of the transaction values of all divested business units within a firm year (at least one transaction value within the segment year should be available as well). Aggregate transaction value to segment sales and aggregate transaction value to segment assets are winsorized at the one- and 99-percentile. Subscripts refer to the year relative to the year in which firms announce a divestment. We truncate ratios at -1 and +1. \*\*\*, \*\*, and \* denote that the means of familiar (divested) segments are significantly different from the means of non-familiar (retained) segments at the 1 percent, 5 percent, and 10 percent level, respectively.

	Familiar									Non-familiar		
	Direct experience			Industry experience			All (1)			All (2)		
	Mean	SD.	N	Mean	SD.	N	Mean	SD.	N	Mean	SD.	N
Years direct experience	8.500	8.832	354	-	-	234	5.117	8.016	588	-	-	335
Years since left direct experience segment	8.698	7.753	348	-	-	-	-	-	-	-	-	
Years industry experience	-	-	354	8.910	8.891	234	3.546	7.101	588	-	-	335
Sales <sub>t-1</sub>	4177	11,439	354	2244	4225	234	3408	9310	588	2499**	4418	334
Relative size	0.390	0.234	354	0.218	0.153	234	0.321	0.222	588	0.230***	0.199	334
Size < 10% dummy	0.079	0.270	354	0.261	0.440	234	0.151	0.359	588	0.260***	0.440	334
Core segment	0.404	0.491	354	0.103	0.304	234	0.284	0.451	588	0.140***	0.348	335
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.202	0.136	351	0.171	0.181	231	0.189	0.156	582	0.232***	0.234	329
Industry-adj. cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.078	0.164	351	0.088	0.197	231	0.082	0.178	582	0.098	0.215	323
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	0.020	0.118	351	0.003	0.100	231	0.013	0.111	582	0.020	0.167	329
Industry-adj. capx <sub>t-1</sub> /sales <sub>t-2</sub>	0.012	0.116	351	0.004	0.098	231	0.009	0.109	582	0.010	0.171	323
Cross-subsidization	0.004	0.099	323	-0.005	0.096	216	0.000	0.098	539	-0.013	0.208	285
Segment's Tobin's $q$	1.608	0.539	354	1.704	0.578	234	1.646	0.556	588	1.593	0.532	330
Segment's industry liquidity	0.115	0.095	352	0.122	0.114	234	0.118	0.103	586	0.133**	0.105	325
Segment's industry R&D to assets	0.033	0.046	353	0.043	0.047	234	0.037	0.047	587	0.027***	0.034	344
Divestment dummy	0.367	0.483	354	0.346	0.477	234	0.359	0.480	588	0.421*	0.494	335
Fully divested segment dummy	0.020	0.140	353	0.039	0.193	233	0.027	0.163	586	0.078***	0.268	335
<i>Subsample of segments with divestments only</i>												
Number of divested business units	1.485	0.908	130	1.185	0.422	81	1.370	0.772	211	1.504	1.138	141
Aggregate transaction value of divested business units (\$-mln)	437.7	1017.3	72	481.8	965.6	46	454.9	993.5	118	453.0	870.6	90
Aggregate transaction value/segment sales <sub>t-1</sub>	0.388	0.848	72	0.566	1.036	46	0.458	0.926	118	0.708*	1.189	90
Aggregate transaction value/segment assets <sub>t-1</sub>	0.345	0.670	72	0.475	0.712	46	0.396	0.686	118	0.531	0.780	89
<b>Panel B: Divested versus retained segments</b>												
	Divested (1)			Retained (2)								
	Mean	SD.	N	Mean	SD.	N						
Direct experience	0.369	0.483	352	0.392	0.489	571						
Industry experience	0.230	0.422	352	0.268	0.443	571						
Sales <sub>t-1</sub>	3763	9778	352	2656*	6457	570						
Sales <sub>t-1</sub> /firm sales <sub>t-1</sub>	0.340	0.244	352	0.257***	0.194	570						
Size < 10% dummy	0.151	0.358	352	0.216**	0.412	570						
Core segment	0.281	0.450	352	0.201***	0.401	571						
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.198	0.194	350	0.209	0.186	561						
Industry-adj. cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.074	0.195	348	0.096*	0.190	557						
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	0.016	0.134	350	0.015	0.134	561						
Industry-adj. capx <sub>t-1</sub> /sales <sub>t-2</sub>	0.007	0.133	348	0.011	0.135	557						
Cross-subsidization	-0.006	0.142	327	-0.003	0.148	497						
Segment's Tobin's $q$	1.637	0.538	351	1.621	0.554	567						
Segment's industry liquidity	0.127	0.104	347	0.121	0.104	564						
Segment's industry R&D to assets	0.034	0.046	352	0.033	0.045	569						

Panel A shows our total sample of 923 segments to consist of 588 familiar and 335 non-familiar segments. Average CEO direct work experience is 8.5 years in 354 segments and of industry experience 8.9 years in 234 segments. Our results indicate that the familiar, relative to non-familiar, segments are significantly larger and more often are core segments. These characteristics of familiar segments are crucial because they may induce a mechanical relation whereby a familiarity effect is driven by experience in the core segment or segment size. Such a mechanical relation could occur in the situation where boards are more likely to appoint as CEOs managers from



core segments, which typically are the largest segments operating in the same industry as the firm's core industry. Although the statistics confirm that a relatively large proportion of direct-experience segments are core segments, we still have 59.6% of non-core direct-experience segments, an issue we discuss further in Section 3.1. We find familiar segments to perform significantly worse than non-familiar segments in terms of segment cash flows, although the difference is not significant after adjusting for industry-level cash flows. Familiar, relative to non-familiar, segments operate in industries that are less liquid but more R&D intensive. Capital expenditures and industry  $q$  do not differ between familiar and non-familiar segments.

Panel A shows, consistent with the comparative information hypothesis, that the percentage of divesting segments is significantly smaller for familiar than for non-familiar segments. A detailed analysis of the subsample of divesting segment years indicates that CEOs divest, on average, 1.37 business units from familiar segments and 1.50 business units from non-familiar segments. The absolute value of the aggregate transaction value of these divestments is comparable for both the familiar and non-familiar segments, but in relative terms, a greater proportion of assets is divested from non-familiar segments (the difference is not statistically significant though).

Panel B shows firms to divest assets from 352 segments and fully retain 571 segments in 266 firm years. The proportion of direct-experience segments does not differ significantly between the retained (36.9%) and divested (39.2%) segments, which result holds as well for the industry-experience segments. In contrast to the results of studies that focus exclusively on fully divested segments (e.g., Dittmar and Shivdasani, 2003; Schlingemann et al., 2002), we show partially divested segments to be larger in terms of both absolute and relative size, indicating that they are too important to be ignored. Larger segments often consist of collections of smaller business units, which increase the likelihood of separable portions of segments being divested.

We also find the proportion of core segments to be higher for the divested than for the retained segments sample. Although this result is counter to the motivation of divesting assets to increase the focus on firms' core business (John and Ofek, 1995), it is consistent with a greater likelihood of assets being divested from larger segments.<sup>10</sup> The finding that industry-adjusted cash flows are lower for divested than for retained segments supports two motives for divesting assets, (1) to reallocate assets to higher-valued users (Jain, 1985), and (2) to obtain funds when external financing is too expensive and internal financing insufficient (Lang et al., 1995).

### 3. Empirical results

#### 3.1. Testing the comparative information hypothesis

We examine whether familiarity influences CEOs' divestment decisions by estimating binary logit regressions in which the dependent variable takes the value of one for divested segments and zero for fully retained segments. We use Schlingemann et al.'s (2002) specification of economic factors. We include segment performance, investment, cross-subsidization, size, and  $q$ , whether a segment is core<sup>11</sup> and is less than 10% of total sales, and the segment industry's liquidity. We include year dummies and dummies for the number of segments in which a firm operates, as reported by the firm. Robust standard errors are clustered by firm. Table 3 reports the results.

The results of Regression (1) largely corroborate the results of Schlingemann et al. (2002). The table provides weak support for the conjecture that CEOs are more likely to divest assets from poorly performing segments, although the two cash flow coefficients are not statistically significant. The results further indicate that CEOs are more likely to divest assets from segments with lower capital expenditures that operate in industries with higher capital expenditures, possibly to economize on cash flows. Segments with greater cross subsidization are also more likely to be divested. The probability of divestment is higher for relatively larger segments (as proxied by segment relative to firm sales). Our results further indicate that CEOs' choice of which assets to divest is not influenced by a segment's imputed  $q$ , whether a segment is core, or whether its sales account for less than 10% of a firm's consolidated sales.

To investigate whether familiarity influences CEOs' divestment decisions, Regression (2) includes the direct-experience dummy. Consistent with the comparative information hypothesis, we find that CEOs are less likely to divest assets from segments in which they have previously worked. The effect is economically significant. An odds ratio of 0.61 indicates that asset divestment occurs only 61% as often among direct-experience as among non-familiar segments. Including the direct-experience dummy significantly increases the regression's explanatory power.<sup>12</sup>

Regressions (3) and (4) report robustness checks cited in the literature on the impact of CEO background on corporate decisions, in which a distinction is made between generalist and specialist CEOs (e.g., Custódio et al., 2013). In our study, the familiarity effect is observed in firms run by both generalists (as part of their broad background) and specialists (in the to-be-divested segment). The effect can also be absent in both groups, because generalist CEOs' experience is not *per se* specifically related to the divesting segment

<sup>10</sup> Note that the focus argument applies to fully divested segments, because the proportion of core segments in this subsample of fully divested segments drops to 9.5%.

<sup>11</sup> We control in our tests for core versus non-core segments based on segment size and two-digit SIC classification. In unreported robustness analyses, we investigate several alternative proxies to distinguish segments that may have a special status within a company (e.g., core segments based on two-digit SIC only, core segments based on three-digit SIC only, and the largest segment based on sales). These alternative proxies do not affect our results for the familiarity effect.

<sup>12</sup> We also analyze whether the number of years of work experience in these segments reinforces the documented familiarity effect and find that it does not. This result (not reported) implies that having worked for a segment drives the familiarity effect and is more important than the duration of experience in the segment. We also investigate the related question of whether the presence of familiar segments affects the proportion of assets firms divest. We find in regression models that explain total transaction value over assets at a firm-year level that none of our firm-level familiarity measures has a significant effect. Thus, familiarity does not affect the corporate strategy to divest; it only affects the decision on which segment to divest. These results are available upon request from the authors.

**Table 3**

Segment divestment binary logit regressions.

This table presents the results of binary logit regressions that explain from which type of segments firms choose to divest assets. The dependent variable takes the value of one for divested segments and zero for retained segments. We measure familiarity by means of CEOs' direct work experience in a segment. The specialist dummy equals one for CEOs in firms that have one direct-experience segment, zero otherwise. The generalist dummy equals one for CEOs familiar (at different levels, i.e., within a firm year segments are either direct-experience or industry-experience) with all the segments, zero otherwise. All other variables are self-explanatory or defined in Table 2. Subscripts refer to the year relative to the year in which firms announce a divestment. We truncate ratios at  $-1$  and  $+1$ . All regressions include year dummies and dummies for the number of segments (unreported). *P*-values appear in parentheses and are based on robust standard errors clustered by firm.

	(1)	(2)	(3)	(4)
Direct experience		-0.494** (0.012)	-0.745*** (0.002)	-0.614*** (0.008)
Specialist			-0.095 (0.602)	
Specialist * direct experience			0.446 (0.173)	
Generalist				-0.333 (0.112)
Generalist * direct experience				0.461 (0.257)
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	-0.576 (0.217)	-0.650 (0.168)	-0.675 (0.149)	-0.657 (0.163)
Industry median cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.909 (0.317)	1.149 (0.215)	1.088 (0.242)	1.089 (0.240)
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	-1.094* (0.083)	-1.096* (0.091)	-1.096* (0.098)	-1.108* (0.087)
Industry median capx <sub>t-1</sub> /sales <sub>t-2</sub>	7.177*** (0.009)	7.134*** (0.011)	6.769*** (0.013)	6.779*** (0.019)
Cross-subsidization	0.800* (0.063)	0.878* (0.052)	0.863* (0.060)	0.882* (0.052)
Relative size	1.992 (0.005)	2.273*** (0.001)	2.077*** (0.005)	2.248*** (0.002)
Core segment	-0.169 (0.533)	-0.070 (0.803)	-0.060 (0.832)	-0.087 (0.763)
Segment's Tobin's <i>q</i>	0.126 (0.464)	0.146 (0.394)	0.133 (0.442)	0.149 (0.384)
Size < 10% dummy	0.119 (0.596)	0.076 (0.734)	0.046 (0.836)	0.093 (0.682)
Liquidity	1.142 (0.181)	1.074 (0.204)	1.103 (0.185)	1.121 (0.188)
Number of observations	823	823	823	823
McFadden <i>R</i> -squared	5.40%	6.16%	6.33%	6.38%

\* Significant at 10%.

\*\* Significant at 5%.

\*\*\* Significant at 1%.

or specialist CEOs' skills and experience are not necessarily related to the divesting segment. The overlap between our definitions and the literature's specialist-generalist distinction is thus not predetermined and remains an empirical question.

To test whether the familiarity effect is more prevalent in firms with generalist or specialist CEOs, Regressions (3) and (4) interact our direct-experience dummy with a specialist and generalist dummy, respectively. We use two definitions to distinguish between specialists and generalists. First, we define specialist CEOs as having direct work experience in one (and not more than one) segment in a firm year. By this definition, 68% of segments are managed by specialist CEOs. Second, we define generalist CEOs as being relatively knowledgeable about all segments within a firm year, either through direct or industry work experience. We use both levels of experience because we need variation in familiarity within a firm year. Under this condition, 27% of segments are managed by generalist CEOs. The regression results show that the interaction terms in both regressions are not significantly different from zero. This suggests that the familiarity effect is similar across firms whether headed by specialist or generalist CEOs. Applying the Delta method (as described in Ai and Norton, 2003) to the interaction term yields the same conclusion.

A final set of robustness tests (unreported) provides a detailed analysis of the role of core segments in the familiarity effect. The statistics in Table 2 reveal that familiar segments are significantly larger and more often are core segments. If boards promote to the CEO position primarily managers with work experience in core segments, the negative coefficient of the direct experience dummy in our reported regressions might reflect firms' decision to focus on their core businesses, which would suggest that the documented familiarity effect is a mechanical relation. We address this issue in two ways. First, we add to our basic regression an interaction term between the direct-experience segment and core segment dummies, as reported in Regression (2) of Table 3. We find the coefficient of the direct-experience segment dummy to remain significantly negative (coefficient equals -0.729, *p*-value below one percent) and the interaction term to be significantly positive (coefficient equals 0.884), with a *p*-value of 0.032 (the average interaction effect is also significant at the five-percent level when the Delta method is applied). This empirical result is contrary to the prediction of a mechanical relation that familiarity effect prevails in core segments. On the contrary, the regression results suggest that the effect is present mainly in non-core, and not in core segments.

**Table 4**

Segment divestment logit regressions: Subsamples split according to CEO tenure.

This table presents the results of binary logit regressions that explain from which type of segments firms choose to divest assets. The dependent variable takes the value of one for divested and zero for fully retained segments. Regressions (1) and (2) contain firm years with CEOs with tenure up to two years. Regression (3) contains firm years with CEOs with tenure of three or more years. We measure familiarity by means of CEOs' direct work experience in a segment. COO is an indicator variable that equals one for all CEOs who held the corporate executive title chief operating officer before being appointed CEO. All other variables are self-explanatory or defined in Table 2. Subscripts refer to the year relative to the year in which firms announce a divestment. We truncate ratios at  $-1$  and  $+1$ . All regressions include year dummies and dummies for the number of segments (unreported). *P*-values appear in parentheses and are based on robust standard errors clustered by firm.

	Newly hired		Longer tenured
	(1)	(2)	(3)
Direct experience	−0.004 (0.991)	1.048** (0.029)	−0.722*** (0.002)
COO		0.207 (0.564)	
COO * Direct experience		−1.505** (0.011)	
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	−1.183 (0.120)	−1.560** (0.042)	−0.341 (0.570)
Industry median cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	0.464 (0.787)	0.132 (0.934)	1.261 (0.242)
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	−1.723** (0.035)	−1.457* (0.060)	−1.535 (0.129)
Industry median capx <sub>t-1</sub> /sales <sub>t-2</sub>	3.049 (0.512)	1.174 (0.808)	8.272*** (0.010)
Cross-subsidization	0.697 (0.137)	0.833* (0.076)	1.679* (0.090)
Relative size	2.672** (0.041)	2.670** (0.042)	2.275** (0.018)
Core segment	−0.224 (0.622)	−0.196 (0.676)	−0.066 (0.852)
Segment's Tobin's <i>q</i>	0.194 (0.551)	0.104 (0.728)	−0.014 (0.952)
Size<10% dummy	0.501 (0.221)	0.573 (0.166)	−0.071 (0.807)
Liquidity	0.546 (0.691)	0.426 (0.762)	1.574 (0.135)
Number of observations	281	279	542
McFadden <i>R</i> -squared	6.79%	9.18%	8.09%

\* Significant at 10%.

\*\* Significant at 5%.

\*\*\* Significant at 1%.

As a second test of the mechanical relation explanation, we construct two samples, (1) firm years in which managers promoted to CEO are from the core segments (i.e., firm years in which the direct-experience segments are also core segments), and (2) firm years in which managers promoted to CEO are from non-core segments (i.e., firm years in which the direct-experience segments are non-core segments). For the mechanical relation explanation to hold, the familiarity effect should prevail in the first sample and not in the second sample. Although we find a negative direct-experience coefficient in both subsamples (the coefficients equal  $-0.351$  and  $-0.651$  for the first and second subsample, respectively), the coefficient is only significant in the second subsample, with firm years in which managers promoted to CEO were from non-core segments (with a *p*-value below one percent). Overall, these extra tests do not support a significant mechanical relation between familiarity and the likelihood of a segment being divested.

### 3.2. Testing the political power hypothesis

We documented in the previous section that CEOs faced with a divestment decision are more inclined to hold onto familiar segments. The evidence supports the comparative information hypothesis. We will show in this section that the possession of superior knowledge concerning familiar segments that drives CEOs' preference for divesting non-familiar segments is often not sufficient for them to act alone. In the political world of multi-divisional firms, the CEOs also need to attain sufficient accumulation of political capital to support implementation of the preferred choice as to which segment(s) to divest.

We test this political power hypothesis by splitting the sample into CEOs with tenure of up to two years and CEOs with tenure of three or more years. The two-year cutoff follows Xuan (2009), who argues that newly hired CEOs are particularly susceptible to political power plays and thus more likely to increase investment in non-familiar segments to promote goodwill towards their managers. Changing the threshold to first three years does not change our conclusions. Regressions (1) and (2) in Table 4 show the results for newly hired CEOs and Regression (3) for longer-tenured CEOs.

Regression (1) shows no significant direct-experience coefficient for newly hired CEOs, which suggests that, consistent with the political power hypothesis, CEOs new to the job realize they have not yet accumulated sufficient political capital to go against powerful segment managers and to act on their preferences.<sup>13</sup>

We further refine the test for the political power hypothesis for the newly hired CEOs by distinguishing between those who held the corporate executive title of COO before being promoted to CEO and those who did not. In the sample of new CEOs, 72% had held the title of COO before being appointed CEO. According to Xuan (2009), new CEOs who previously served as COO have less need to “bridge-build” with managers of non-familiar segments because the former title accords them status as successor and thereby authority in the firm. Regression (2) shows an interaction term added between the direct-experience dummy and COO title dummy to be significantly negative (the average interaction effect is also significant at the five-percent level when the Delta method is applied). Moreover, the direct-experience dummy is now positively associated with the likelihood of divestment. These results suggest that the least powerful new CEOs are more inclined to seek the goodwill of managers of non-familiar segments by not divesting assets from their segments. This result is consistent with Xuan's (2009) finding that less powerful (new) CEOs increase investment in non-familiar segments. A familiarity effect is not manifested among new CEOs with more political power (the *p*-value of the sum of the direct experience coefficient and interaction coefficient is 0.323).

For the subsample of longer-tenured CEOs, the direct-experience coefficient is significantly negative (Regression (3)). The odds ratio of 0.486 suggests that 51.4% fewer divestments take place in direct-experience segments compared to non-familiar segments. This is in line with our conjecture that it takes longer-tenured CEOs to have accumulated sufficient political power to implement their preference to divest non-familiar segments.

Our evidence supports the political power hypothesis. New CEOs with the least authority favor non-familiar segments and spare these segments from divesting, while more established CEOs who have accumulated sufficient political capital can favor the familiar segments in their divestment decisions.

### 3.3. Additional tests of the comparative information hypothesis

In the previous section, we established that CEOs first have to accumulate sufficient internal political capital before they can carry out their preferred choice of divesting non-familiar assets, which is consistent with the political power hypothesis. This finding is also consistent with the comparative information hypothesis and provides a necessary condition – sufficient political power – for the comparative information hypothesis to hold. In this section, we further test the comparative information hypothesis by investigating whether the familiarity effect is more pronounced in segments in which longer-tenured CEOs' comparative information advantage is greater. We first add another dimension of familiarity with segments based mainly on industry experience. We next investigate instances in which a deeper understanding of a segment's products, processes, and technology is required.

The comparative information advantage may depend on whether segments operate in the same industry as a CEO's direct-experience segment. If so, the knowledge and industry background the CEO shares with segment managers stimulates information sharing between the two parties. We therefore maintain that CEOs are more knowledgeable about related (also referred to as industry-experience) than unrelated segments. They nevertheless have less firsthand knowledge about industry-experience than about their direct-experience segments. The intuition behind this difference is that CEOs possess more specific knowledge of segments in which they have worked. They also enjoy stronger connections, and a concomitant greater level of trust, with those with whom they worked in their direct-experience segments. We therefore expect CEOs to divest assets from segments with which they are least familiar.

Regression (1) of Table 5 adds to our logit regression a dummy variable for industry experience that explains a segment's likelihood of being divested by established CEOs. The industry-experience coefficient is negative and significant at the ten-percent level. Consistent with our prior, its effect is smaller and less significant than the direct-experience effect. We conclude from these results that CEOs' comparative information advantage diminishes with the distance from firsthand knowledge about a segment, which increases their willingness to divest assets from more distanced segments.

We focus on segments that operate in R&D intensive industries, where the CEOs' comparative information advantage with respect to familiar segments is expected to be greater. One reason is that the outcomes of investment in R&D are highly uncertain and difficult to accurately assess at the investment stage. These CEOs also have either the technical credentials or acquired the technical knowledge while working at these segments. According to Miao and Sandford's (2013) model, this results in a comparative advantage that leads CEOs to retain familiar segments. Another reason is that R&D decisions are based on soft information that is difficult to quantify and transmit in an impersonal way (Petersen, 2004). In such a setting, CEOs must rely on information provided by segment managers. Some segment managers may use more liberty to overstate their segments' needs and prospects in the hope of receiving a greater budget allocation. A natural response of CEOs is to more greatly discount these segments' budget requests (Bernardo et al., 2001), asset divestments being an extreme form of discount.

We argue that CEOs' direct work experience in R&D intensive segments can overcome the asymmetric information problem by affording a deeper understanding of the products, processes, and technologies of these segments and their competitors. This deeper understanding should diminish the incentives for managers to misrepresent their segments' needs and prospects. Moreover, frequent

<sup>13</sup> We note that CEOs with little political clout can minimize the political consequences of divestments of non-familiar assets by strategically deciding on the relative size of the divestments. For instance, new CEOs with little political clout could opt for divestments of full segments, because the segment manager will leave the company after the divestment. Unreported results indicate that in our sub sample of newly hired CEOs 9.5% of the non-familiar segments are fully divested versus 3.8% of the direct experience segments (*p*-value of the difference equals 0.086).

**Table 5**

Segment divestment logit regressions: Information advantage of longer-tenured CEOs.

This table presents the results of binary logit regressions that explain from which type of segments firms choose to divest assets for the subsample of firm years with CEOs with three or more years of tenure. The dependent variable takes the value of one for divested segments and zero for fully retained segments. We measure familiarity by means of CEOs' direct work experience in a segment. Industry experience is an indicator variable that equals one for segments that operate in the same two-digit industry as the direct-experience segment. R&D intensive industry is an indicator variable for industry R&D to assets above the sample median. A segment's industry R&D to assets equals R&D expenditures of all Compustat single-segment firms with the same two-digit SIC code weighted by the firms' beginning of year total assets. We code missing values of R&D as zero. All other variables are self-explanatory or defined in Table 2. Subscripts refer to the year relative to the year in which firms announce a divestment. We truncate ratios at  $-1$  and  $+1$ . All regressions include year dummies and dummies for the number of segments (unreported). *P*-values appear in parentheses and are based on robust standard errors clustered by firm.

	(1)	(2)
Direct experience	−0.946*** (0.001)	−0.341 (0.293)
Industry experience	−0.560* (0.072)	
R&D intensive industry		0.144 (0.621)
R&D intensive industry * direct experience		−0.911** (0.029)
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	−0.462 (0.446)	−0.293 (0.630)
Industry median cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	1.022 (0.339)	1.073 (0.317)
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	−1.493 (0.155)	−1.348 (0.183)
Industry median capx <sub>t-1</sub> /sales <sub>t-2</sub>	7.707** (0.014)	7.832** (0.018)
Cross-subsidization	1.597 (0.113)	1.446 (0.152)
Relative size	2.202** (0.024)	2.579*** (0.006)
Core segment	−0.056 (0.878)	−0.164 (0.640)
Segment's Tobin's <i>q</i>	−0.011 (0.961)	0.085 (0.759)
Size <10% dummy	−0.079 (0.796)	−0.004 (0.990)
Liquidity	1.478 (0.160)	1.204 (0.298)
Number of observations	542	542
McFadden <i>R</i> -squared	8.74%	8.83%

\* Significant at 10%.

\*\* Significant at 5%.

\*\*\* Significant at 1%.

personal encounters and a greater degree of mutual trust between CEOs and direct-experience segment managers keep CEOs well informed about the developments in these segments. This information is particularly important for segments that operate in R&D intensive industries where information is hard to quantify and CEOs are more dependent on trusting their information source. CEOs do not possess as great information benefits in the case of non-familiar segments. Therefore, under the comparative information advantage hypothesis, the familiarity effect is predicted to be particularly pronounced for segments that operate in R&D intensive industries.

To test this expectation, Regression (2) of Table 5 adds to the logit regression an interaction term between the direct-experience dummy and a dummy for segments that operate in R&D intensive industries (i.e., single-segment industry R&D expenditures to total assets above the sample median) that explains the likelihood of divestment by longer-tenured CEOs. Our finding of a negative interaction coefficient significant at the five-percent level (the *p*-value of the average interaction effect when the Delta method is applied is 0.057) suggests that the likelihood of established CEOs divesting segments that operate in R&D intensive industries is significantly lower for direct-experience than for non-familiar segments.<sup>14</sup> This difference is not significant for segments that operate in low R&D intensive industries.

So far, we have argued that mutual trust and frequent interactions between direct-experience segment managers and CEOs result in a persistence of CEOs' comparative information advantage over direct-experience segments. However, it is also plausible that their information advantage diminishes over time. In unreported analyses, we test whether the familiarity effect in the subsample of segments operating in R&D intensive industries is stronger for established CEOs earlier in their tenure by adding an interaction coefficient between the direct-experience dummy and CEO tenure.<sup>15</sup> We find no significant interaction term, suggesting that CEOs' information advantage does not significantly diminish over time.

<sup>14</sup> This result also holds when the industry-experience dummy is added to the regression.

<sup>15</sup> We run four regressions with an interaction term between (1) direct-experience dummy and the natural log of the years of CEO tenure; (2) direct-experience dummy and dummy for CEO tenure up to five years; (3) direct-experience dummy and dummy for CEO tenure up to six years; and (4) direct-experience dummy and dummy for CEO tenure up to seven years (results unreported).

#### 4. Alternate explanations

We examine here three competing explanations for why CEOs choose to keep business segments in which they have previously worked. These are: (1) CEO selection by boards, (2) internal promotion considerations, and (3) CEO entrenchment.

##### 4.1. Board CEO selection

Considerations in the CEO selection process may be the underlying explanation for the familiarity effect, inasmuch as boards of directors take into account candidates' prior work experience in the selection process for a new CEO. If, for example, a board chooses a CEO with the aim of focusing on and growing, as part of long-term firm strategy, a business segment with which the candidate is familiar, segments with which the new CEO is not familiar will be strategically less important. In such instances, CEOs will be less likely to divest assets from familiar segments. Huang (2010) investigates divestments of complete segments in relation to an industry-based measure for the match between CEO expertise and retained assets. He finds evidence that the appointment of CEOs improves firm performance in cases of a match between CEO expertise and firm assets.

Our finding that the preference to divest from non-familiar segments is not exhibited during the first two years of a CEO's tenure argues against the board CEO selection explanation. Weisbach (1995) argues that newly appointed CEOs are least likely to divest assets congruent with their skill sets. Moreover, CEOs with two or three years of tenure have typically acquired adequate knowledge from different sources and gained sufficient political leverage to support deviations from their original mandate (Hambrick and Fukutomi, 1991). The familiarity effect, if it is explained by board CEO selection, should be pronounced early in a CEO's tenure. This is not what we find.

We nevertheless further test the selection explanation using a two-step procedure to distinguish between the board selection decision and CEO divestment decision. In the first step, we estimate a model to predict which segment is likely to be divested. In the second step, we use the first-step coefficients to predict the probability of a segment's assets being divested using information from one year prior to CEO appointment. If CEOs were hired to grow their direct-experience segment, the predicted probability of a segment being divested should be the lowest (highest) for the direct-experience (non-familiar) segments.

To predict the likelihood of a segment divestment in the first step, we use our standard model as presented in Regression (1) of Table 3, taking the full sample of 608 firm years, rather than the subsample of firm years with variation in familiarity, to minimize the likelihood that any form of familiarity would affect the determinants of segment divestment (see Section 2.1 for our sample selection procedure). Regression (2) incorporates only segments in firm years with CEOs who succeed to that position one or two years prior to divestment and provides a stronger specification for testing the selection explanation. Regression (3) is an even stronger specification in using the subset of divesting firm years with externally hired CEOs with tenure up to two years.<sup>16</sup> The skills of the latter group of CEOs should relate to the remaining assets and be less correlated with recently divested assets. Because the year of CEO appointment can occur prior to 1996, and our estimation period is from 1996 to 2004, we do not control in the first-step regression for the year in which divestment takes place. Our sample contains 70 CEO-firm combinations and 236 segment years.<sup>17</sup> Table 6 presents the results.

Panel A reports the coefficients for the three regression models that estimate the predicted probability of a segment being divested (first step). Panel B presents the statistics of the predicted probability per level of familiarity in the year prior to CEO appointment based on all three regression models in Panel A (second step). With an average predicted probability of 41.5% and median of 40.0% (using Regression (1) from Panel A), there is no evidence that boards appoint CEOs whose direct-experience segments have the lowest predicted probability of being divested. Moreover, the average and median predicted probabilities for direct-experience segments are significantly higher than those for non-familiar segments ( $p$ -value equals 0.003 and 0.001, respectively). Our results are robust to using different regression specifications (as documented in Panel A); the average or median predicted probability of being divested is not significantly larger for direct-experience than for non-familiar segments with any of these specifications. We find a similar predicted probability of being divested for industry-experience relative to non-familiar segments.

Overall, our evidence does not support the CEO selection explanation for the familiarity effect, but suggests instead that boards select CEOs to restructure their direct-experience segments. Our earlier finding that newly hired CEOs with the least political power tend to divest direct-experience segments is consistent with this prediction. For the selection story to hold, however, the familiarity effect should exist for new CEOs with and without political power (as discussed in Section 3.2).

##### 4.2. Internal promotion considerations

Another explanation for the documented familiarity effect is that managers of poorly performing segments are unlikely to be promoted to the CEO position. CEOs are more likely to advance from the ranks of superior performing segments, which are the

<sup>16</sup> Our results also hold when we estimate the regression based on a subset of divesting firm years with all externally hired CEOs (i.e., both newly-hired and longer-tenured external CEOs) (results are unreported).

<sup>17</sup> The sample of firm years with variation in familiarity contains 134 CEO-firm combinations. We remove 64 combinations for the following reasons: for 31 CEO-firms no financial data is available or we observe a change in segment reporting (we lose firm years when we miss information for even one segment within a firm year); for 13 CEO-firms, the firms report one segment when the CEO was appointed; for five CEO-firms, we cannot download the information from Compustat because the CEO was appointed prior to 1979 or because no Compustat coverage exists in the year prior to appointment; for two CEO-firms we lose variation in familiarity between segments; and for 13 cases the CEO had been appointed in the year of the divestment (if these observations were included, the estimation of the model and predicted probability would be based on the same data).

**Table 6**

CEO selection.

Panel A presents the results of a binary logit regression that explains from which type of segments firms choose to divest assets. Model (1) consists of the full sample of 608 divesting firm years, Model (2) the subsample of divesting firm years with CEOs with tenure up to two years, and Model (3) the subsample of divesting firm years with externally hired CEOs with tenure up to two years. The three models also include, in addition to our sample, which is selected on the basis of variation in familiarity within a firm year, firm years without the variation requirement. The dependent variable takes the value of one for divested segments and zero for fully retained segments. Table 2 defines all variables. The subscripts refer to the year relative to the year in which firms announce a divestment. We truncate ratios at  $-1$  and  $+1$ . All regressions include dummies for the number of segments (unreported). *P*-values appear in parentheses and are based on robust standard errors clustered by firm. In Panel B, which presents the relation between the predicted probability of a segment being divested, we use the coefficients reported in Panel A for firm years prior to CEO appointment. The panel presents the mean, median, and standard deviation of this predicted probability per level of familiarity for the subsample of firm years with variation in familiarity. We measure familiarity by means of the CEOs' work experience, split into direct-experience, industry-experience, and non-familiar segments.

Panel A: Segment divestment binary logit regression					
	(1)	(2)	(3)		
	Full sample	Newly hired	Newly and externally hired		
Cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	-0.598** (0.037)	-1.083** (0.031)	-1.533 (0.137)		
Industry median cash flow <sub>t-1</sub> /sales <sub>t-2</sub>	1.386*** (0.008)	0.436 (0.689)	-1.622 (0.390)		
Capx <sub>t-1</sub> /sales <sub>t-2</sub>	-0.279 (0.468)	-0.657 (0.220)	-0.606 (0.501)		
Industry median capx <sub>t-1</sub> /sales <sub>t-2</sub>	1.789 (0.354)	4.637 (0.182)	7.222 (0.454)		
Cross-subsidization	0.405 (0.326)	0.363 (0.338)	1.541 (0.407)		
Sales <sub>t-1</sub> /firm sales <sub>t-2</sub>	1.058** (0.029)	1.738** (0.049)	1.288 (0.451)		
Core segment	-0.062 (0.755)	-0.262 (0.446)	-0.497 (0.505)		
Segment's Tobin's <i>q</i>	0.272*** (0.005)	0.390** (0.032)	0.787** (0.027)		
Size <10% dummy	-0.099 (0.531)	0.071 (0.812)	-0.212 (0.725)		
Liquidity	0.288 (0.576)	0.341 (0.686)	-0.081 (0.954)		
Number of observations	1805	578	180		
McFadden <i>R</i> -squared	4.01%	4.12%	9.16%		
*Significant at 10%, **Significant at 5%, ***Significant at 1%.					
Panel B: Predicted probability of divestment per type of familiarity					
	Direct exp.	Industry exp.	Non-familiar	<i>P</i> -value of differences	
	(1)	(2)	(3)	(1)-(3)	(2)-(3)
N	91	54	91		
<i>Predicted probabilities based on the coefficients in Model (1)</i>					
Mean	0.415	0.341	0.370	<b>0.003</b>	<b>0.040</b>
Median	0.400	0.331	0.353	<b>0.001</b>	0.116
SD.	0.104	0.069	0.100		
<i>Predicted probabilities based on the coefficients in Model (2)</i>					
Mean	0.411	0.348	0.370	<b>0.014</b>	0.122
Median	0.401	0.341	0.354	<b>0.018</b>	0.217
SD.	0.116	0.068	0.106		
<i>Predicted probabilities based on the coefficients in Model (3)</i>					
Mean	0.351	0.311	0.332	0.453	0.477
Median	0.371	0.332	0.337	0.313	0.584
SD.	0.160	0.158	0.179		

least likely to be divested. Our empirical evidence does not support this alternate explanation. For this explanation to hold, we should observe the familiarity effect mainly at the beginning of a CEO's tenure, which we do not. Another implication is that the direct-experience segments of firms managed by new CEOs should perform better than non-familiar segments. But a comparison (not tabulated) of the segments' and industry-adjusted cash flows for the subsample of newly hired CEOs does not show a significant difference in performance (*p*-values of the difference equal 0.599 and 0.610 for segment and industry-adjusted segment cash flows, respectively). We document in the previous section a lower rather than higher predicted probability of a segment being divested, which is yet further evidence counter to the performance-related selection explanation.

### 4.3. Managerial entrenchment

CEOs might favor familiar segments based on agency theory. One way to maximize their utility is for CEOs to facilitate their entrenchment, as by investing in assets that are complementary to their skills and thereby making themselves more valuable to shareholders and more costly to replace (Shleifer and Vishny, 1989). CEOs can achieve the same end by divesting assets from non-familiar segments and increasing the share of familiar assets.

Being the agents who realize the greatest marginal benefits from actions to entrench themselves, our finding that newly hired CEOs do not exhibit a significant familiarity effect is evidence against the entrenchment explanation. In untabulated analyses, we perform two additional tests in which we consider entrenchment as related to external and internal governance.<sup>18</sup> We use as an external governance measure the entrenchment index of Bebchuk et al. (2009), which contains six provisions that isolate executives from hostile acquisitions and from shareholders' ability to impose their will on them. If entrenchment explains the familiarity effect, we expect more entrenched CEOs to manifest a stronger familiarity effect.<sup>19</sup> We test this hypothesis by including in Regressions (1) and (3) of Table 4 an interaction term with the direct-experience dummy and a dummy for an above sample median entrenchment index (i.e., equal to three or higher). We find neither newly hired nor established CEOs with a high entrenchment index to exhibit a stronger familiarity bias. This result is not consistent with the entrenchment explanation.

For our second test of the entrenchment explanation, we use a measure of internal corporate governance. We expect good corporate governance to induce CEOs to make value-maximizing decisions for the firm rather than for themselves. CEOs of firms with more independent directors have less power over the board, hence, less discretion over their decisions (e.g., Moeller, 2005; Paul, 2007; Ryan and Wiggins, 2004). If the familiarity effect is caused by the desire to become entrenched, CEOs in well governed firms would not exhibit this bias. We find that an interaction term with the direct-experience dummy and a dummy for above median percentage of independent directors is not significant in the sample of newly hired CEOs, nor is it significant in the sample of longer-tenured CEOs. Using other governance measures, such as CEO ownership or the Gompers et al. (2003) governance index, yields the same conclusion. These results are not consistent with the entrenchment explanation.

## 5. The value-relevance of familiarity

Our results thus far suggest that CEOs' comparative information advantage leads to a preference to divest from non-familiar segments, but that insufficient political power can constrain them to carry out their preference. This section investigates, by means of an event study, how the stock market perceives the familiarity effect.

It is an empirical question how the market response to divestment announcements of familiar assets differs from that of non-familiar assets. On the one hand, divesting familiar assets, relative to non-familiar assets, can generate lower abnormal returns for the selling firm. If the divested assets are familiar to the selling firm's CEO, buyers are less likely to be higher-valued users regarding their knowledge and skills to optimally manage these assets, reducing the buyer's premium for the assets. On the other hand, the returns from divesting familiar assets may be higher than returns from divesting non-familiar assets, as CEOs can use their superior information to pick winners (Stein, 1997) by divesting underperforming assets from familiar segments or exploiting an overvaluation of their assets. Additionally, CEOs who divest familiar assets have a comparative advantage in locating and bargaining with potential buyers. Previous studies provide empirical evidence consistent with these arguments by showing that acquiring firms in close geographic proximity (Uysal et al., 2008) or that operate in industries in which CEOs have work experience (Custódio and Metzger, 2012) generates higher abnormal returns.

Because established CEOs have the political power to more freely act according to their preference to divest from non-familiar segments, they may also be more likely to effectively use their comparative information advantage in their divestment decisions. We therefore distinguish in our analysis between newly-hired and longer-tenured CEOs.

Our sample includes 500 announcements of divested business units. Of those announcements, we have 438 observations with available return data on a unique divestment date.<sup>20</sup> To avoid the possibility that outliers drive our results, we winsorize CARs at the one- and 99-percentiles. To test our results in a multivariate setting, we additionally require complete information on transaction size (accounting for the economic significance of divestments) and on other deal and firm-specific characteristics. This requirement reduces our sample to 208 observations.<sup>21</sup> The average (median) transaction value of these 208 divestments amounts to 5.5% (1.1%) of the book value of the firms' total assets; the 25- and 75-percentiles are, respectively, 0.3% and 5.5%. Table 7 provides the abnormal return statistics for the full sample, for the subsamples of divestments of direct-experience, industry-experience, and non-familiar segments, and for the subsamples of longer-tenured and newly hired CEOs.

Our results show an average positive market response to divestment announcements that varies across types of divestment. We find direct-experience divestments to generate, on average, 1.27% abnormal returns, which is the strongest market response across the various types of divestment. Divestments of non-familiar segments generate an insignificant average of 0.34%. The difference, however, is not significant ( $p$ -value of 0.157). Splitting the sample into divestments announced by newly hired and longer-tenured

<sup>18</sup> The results are available upon request.

<sup>19</sup> Although one could argue that already entrenched CEOs need not divest non-familiar segments to facilitate their entrenchment, we expect entrenched managers, having to choose which assets to divest, not to take actions that could weaken their entrenchment.

<sup>20</sup> By unique divestment date, we refer to 13 cases in which SDC reports two or three separate divestment announcements occurring on the same date in the same segment (but for separate business units). In such instances, we aggregate the information into one observation.

<sup>21</sup> We lose 213 observations due to missing transaction values and another 17 observations due to missing values for industry-adjusted capital expenditures and CEO equity ownership.



**Table 7**

Analysis of CARs to divestment announcements.

This table presents the means, standard deviations, and mean differences of the cumulative abnormal returns over days  $-1$  to  $+1$  relative to a divestment announcement. We estimate abnormal returns by means of the market model with an estimation window running from day  $-160$  to day  $-41$  relative to the announcement date. Abnormal returns are winsorized at the one- and 99-percentile values. We measure familiarity by means of CEOs' direct and industry experience in a segment. Newly hired CEOs are CEOs with tenure up to two years, longer-tenured CEOs, CEOs with tenure of three or more years. The mean return measures denoted with \*\*\*, \*\*, or \* are significant at the 1%, 5%, or 10% level, respectively.

		Direct experience	Industry experience	Non-familiar
		(1)	(2)	(3)
Full sample	Mean	1.27%***	0.22%	0.34%
	St.dev.	(3.94%)	(4.64%)	(4.42%)
	N	76	40	92
Longer-tenured CEOs	Mean	1.62%***	0.42%	0.18%
	St.dev.	(3.86%)	(3.49%)	(4.50%)
	N	43	23	73
Newly hired CEOs	Mean	0.80%	-0.05%	0.96%
	St.dev.	(4.05%)	(5.96%)	(4.17%)
	N	33	17	19

CEOs exacerbates the difference; a positive average abnormal return of 1.62% for announced divestments of direct-experience segments by longer-tenured CEOs compares to a positive average abnormal return of 0.18% for announced divestments of non-familiar segments by such CEOs.<sup>22</sup> In unreported analyses (available upon request), we find that our results hold in a multivariate setting for the full sample (with a direct-experience coefficient equal to 0.012 and  $p$ -value of 0.128) and for the sub sample of longer-tenured CEOs (with a direct-experience coefficient equal to 0.016 and  $p$ -value of 0.115).

Overall, our results imply that the valuation effect underpins the value-relevance of the familiarity effect in cases in which CEOs have direct work experience and sufficient political power to make divestment decisions according to their preferences and thereby maximize their comparative information advantage.

## 6. Conclusion

Our paper examines the impact of CEOs' career paths on corporate decisions. We examine how familiarity arising from work experience in a segment or its industry influences CEOs' divestment decisions. We empirically show CEOs to be less likely to divest assets from familiar than from non-familiar segments.

We argue that the familiarity effect is driven by a trade-off between two forces, a comparative information advantage and political power. CEOs have an information advantage with respect to familiar segments because of their deeper understanding of the segments' business. Consistent with this information advantage, we find a stronger effect for direct than for industry experience. The familiarity effect is also more pronounced in high R&D intensive industries. CEOs, however, also need to possess sufficient political power to act according to their preferences. We find evidence of the necessity of political clout, because the familiarity effect is significant in the sample of longer-tenured CEOs, but not in the sample of their newly hired peers. We finally investigate the value effects of familiarity. Divestments of direct-experience segments exhibit a 1.2% higher abnormal return. Our findings contribute to the investment and internal capital markets literature by emphasizing the relevance of a CEO's career path and internal politics in the determination of firm strategy.

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<sup>22</sup> With a  $p$ -value equal to 0.081, this difference is statistically significant.

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