Does Managerial Ability Remain Valuable During Economic Shocks?

Evidence from Monetary Policy

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Abstract

Managerial ability is often viewed as a source of competitive advantage, but its value may diminish when economic conditions change. We examine whether managerial ability remains valuable during monetary policy shocks and whether financial markets recognize this adaptive capacity. Firms led by more able managers experience more favorable stock price reactions to both expansionary and contractionary monetary policy surprises. Exploiting plausibly exogenous CEO turnover, we provide evidence consistent with a causal interpretation. More able managers also facilitate more stable adjustment, with firm growth and capital structure exhibiting lower volatility, thereby avoiding costly fluctuations in investment and financing decisions.

Keywords: Monetary Policy; Managerial Ability; Stock Returns; Investment; Leverage.
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The authors declare no conflict of interest.
The managerial ability data used in the paper is made public on:
https://peterdemerjian.weebly.com/managerialability.html
The monetary shock datasets are available on:
https://www.federalreserve.gov/econres/feds/a-unified-measure-of-fed-monetary-policy-shocks.htm
https://marekjarocinski.github.io/jkshocks/jkshocks.html
The firm-related data is proprietary.

1. Introduction

Managerial ability is widely regarded as a fundamental determinant of corporate performance (Bonsall et al. 2017; Shang 2021; Chen et al. 2015). Firms operate in complex and uncertain environments in which managers continuously allocate capital, evaluate investment opportunities, adjust financing policies, and respond to changing economic conditions. A substantial literature argues that able managers perform these tasks more effectively, generating superior operating performance and firm value through better judgment, resource allocation, and strategic decision-making (Demerjian et al. 2012; Koester et al. 2017; Chen et al. 2015).

Yet an important question remains unanswered: does managerial ability become more or less valuable when firms face major economic disruptions? On the one hand, able managers may possess the flexibility and judgment required to adapt quickly to changing economic conditions. On the other hand, managerial expertise is accumulated under particular economic environments, implying that significant changes in those environments may render previously successful skills and routines less effective, and even detrimental to adaptation (Leonard-Barton, 1992; Teece et al., 2016; Wang et al., 2015). Whether managerial prevailing ability retains its value when firms confront major economic shocks is therefore ultimately an empirical question.

In this paper, we use monetary policy as the empirical setting to examine this question. Monetary policy is particularly well suited to our analysis for two reasons. First, over the past three decades, central banks have assumed an increasingly active role in stabilizing economic activity through interest rate adjustments, liquidity provision, and unconventional policy interventions (Breitenlechner et al., 2021; Ferrante, 2019; Hattori et al., 2016). Consequently, monetary policy has become one of the most consequential

determinants of firms' financing conditions, investment opportunities, and future prospects (Cloyne et al., 2023; Ottonello & Winberry, 2020). Monetary policy announcements therefore constitute economically significant events that require firms to reassess investment, financing, and capital allocation decisions.

Second, the scheduled nature of Federal Open Market Committee (FOMC) announcements provides a clean setting for assessing whether equity investors place greater value on firms led by more able managers when monetary conditions unexpectedly change (Chen 2007; Kurov 2010, 2012; Bernanke and Kuttner 2005). Stock prices immediately incorporate investors' expectations about firms' ability to navigate the new economic environment, allowing us to observe the market's assessment before examining the subsequent actions managers take.

We therefore begin with an event-study analysis of firms' stock price reactions to monetary policy announcements before turning to the real adjustments managers subsequently undertake through investment and financing decisions. Specifically, we test whether firms led by more able managers experience more favorable stock market reactions to monetary policy announcements and subsequently exhibit more stable adjustment in their growth and capital structure decisions in response to monetary shocks. In doing so, we contribute to the growing literature on the heterogeneous effects of monetary policy across firms by identifying managerial ability as a previously unexplored source of this heterogeneity, complementing existing explanations based on firm characteristics such as size (Gertler & Gilchrist, 1994), financial constraints (Cloyne et al., 2023; Ottonello & Winberry, 2020), and industry (Durante et al., 2022).

We begin with an event-study analysis using a dataset of 244 Federal Reserve announcements and 1,351 firms over the period 1994–2022. Applying the Demerjian et

al. (2012) decomposition of firm efficiency into managerial ability and structural efficiency, we find that firms led by more able managers experience significantly more favorable stock price reactions to both expansionary and contractionary monetary policy surprises. Economically, a one-standard-deviation contractionary monetary policy surprise reduces the firm's cumulative abnormal return (CAR) by up to 0.20%. This decline is partly offset by the increase in the managerial ability score. Following an expansionary monetary policy surprise, moving from the first to the third quartile of managerial ability increases the firm's CAR by up to 0.20 percentage points. These results are robust to the inclusion of alternative fixed effects and a comprehensive set of firm- and macroeconomic-level control variables, including board independence. Our insights remain unchanged when we employ an alternative measure of monetary policy surprises that is robust to the Federal Reserve information effect, under which contractionary (expansionary) surprises are interpreted as positive (negative) signals about the Federal Reserve's assessment of the economy.

To examine whether these findings reflect a causal effect of managerial ability rather than differences in firm characteristics, we exploit plausibly exogenous changes in leadership arising from CEO death. Focusing on Federal Open Market Committee (FOMC) announcements during a limited window following CEO succession, we examine whether changes in managerial ability lead equity investors to reassess the firm's future prospects following monetary policy shocks. The results are consistent with a causal interpretation, indicating that managerial ability causally influences how financial markets evaluate firms' ability to navigate changing macroeconomic conditions.

We next move beyond financial markets' immediate assessment to examine whether these expectations are subsequently reflected in firms' corporate policies. Using

a firm-quarter panel, we evaluate the firms' growth and capital structure decisions following monetary policy shocks. We find that firms led by managers who were deemed more able prior to the shock exhibit significantly less volatile adjustments following both expansionary and contractionary monetary policy shocks. In particular, both firm growth and changes in capital structure are more stable among firms led by more able managers. These findings suggest that managerial ability facilitates adaptation not necessarily through more aggressive adjustments, but by allowing firms to respond to changing monetary conditions while avoiding costly fluctuations in their investment and financing decisions. Taken together, the results provide a potential explanation for the favorable stock market reactions documented in the event study: investors appear to value the ability of more capable managers to navigate monetary policy shocks while maintaining greater stability in firms' subsequent corporate decisions.

Our paper contributes to several strands of literature. We contribute to the literature on managerial ability. Prior research has shown that able managers improve a wide range of firm outcomes, such as credit risk assessment (Bonsall et al., 2017), tax exposure (Koester et al., 2017), innovation (Chen et al. 2015), and earnings (Demerjian et al., 2013). We extend this literature by demonstrating that the benefits of managerial ability are not confined to normal operating environments. Instead, managerial ability remains valuable when firms face changing macroeconomic conditions, enabling firms to respond more effectively to monetary policy shocks. In doing so, we introduce a dynamic dimension to the managerial ability literature, showing that its benefits persist when firms are required to adapt to major economic disruptions rather than merely manage day-to-day operations.

Our findings also qualify the competence-trap perspective by suggesting that changes in the economic environment need not render previously accumulated managerial capabilities obsolete. The capability literature recognizes that capabilities can evolve as their environments change, including through the redeployment, recombination, and transformation of existing knowledge and skills into new applications (Helfat & Peteraf, 2003). What becomes problematic, therefore, may not be accumulated competence itself, but rigidity in its application: competence traps arise when previously successful routines continue to be exploited despite changes in the conditions that made them effective (Levinthal and March 1993; Leonard-Barton 1992; Wang et al. 2015).

This distinction is particularly relevant for managerial ability. Managers may retain underlying capabilities in judgment, information processing, and resource allocation while applying those capabilities differently as economic conditions change. Consistent with this interpretation, research on managerial cognitive capabilities argues that managerial skills can support the sensing, seizing, and reconfiguration required for strategic change (Helfat & Peteraf, 2015). Hence, an interpretation of our findings is that managerial ability remains valuable not because able managers continue doing what previously made them successful, but because they are better able to redeploy their accumulated capabilities in a new economic context.

Furthermore, we contribute to the growing literature on the heterogeneous effects of monetary policy on firms. Existing studies show that firms' responses to monetary policy vary systematically with characteristics such as size (Gertler and Gilchrist 1994), leverage (Ottonello and Winberry 2020), age (Cloyne et al. 2023), and industry (Durante et al. 2022). We identify managerial ability as a previously unexplored source of this heterogeneity. More importantly, by examining stock market reactions to scheduled

monetary policy announcements, we show that equity investors consistently place a premium on managerial ability following both expansionary and contractionary monetary policy surprises. This symmetry suggests that investors value managerial ability not because it is associated with a particular direction of monetary policy, but because it enhances firms' capacity to adapt to changing macroeconomic conditions regardless of whether policy becomes more accommodative or more restrictive.

This paper is organized as follows: Section 2 provides the conceptual background and outlines our predictions. Section 3 introduces the key dataset used in our event-study analysis, which covers operational efficiency, managerial ability, in addition to monetary surprises. Section 4 presents findings from our initial event study analysis. Section 5 evaluates the firm-level response to monetary shocks, from both an investment and leverage standpoints. Finally, Section 6 concludes.

2. Background and Hypotheses

Managerial ability has long been recognized as an important determinant of firm performance. Beyond differences in firm resources or market conditions, managers differ in their capacity to interpret information, allocate resources efficiently, anticipate future opportunities, and respond to uncertainty (Crossland et al., 2014; Demerjian et al., 2012; Koester et al., 2017). A substantial body of research shows that more able managers improve operating efficiency, make superior investment and financing decisions, enhance innovation, and create firm value by making better strategic decisions under uncertainty (Shang 2021; Chen et al. 2015; Cornaggia et al. 2017). These findings are consistent with the Kirzner (1973, 1997) notion of entrepreneurial alertness, whereby superior decision makers recognize opportunities that others overlook and adapt more effectively to changing circumstances. Collectively, this literature suggests that managerial ability

constitutes an important source of competitive advantage because able managers are better equipped to interpret information and allocate organizational resources in response to evolving economic conditions.

However, the very process through which managerial ability is developed also gives rise to an important theoretical tension. Managerial expertise is not acquired in isolation but is honed through repeated decision-making within a particular economic environment. As managers repeatedly confront similar challenges, successful judgments are reinforced, heuristics become refined, and decision-making processes become increasingly routinized. This accumulated experience enables managers to recognize recurring patterns, improve resource allocation, and make increasingly efficient decisions under familiar conditions. Consequently, managerial ability reflects not only innate talent but also knowledge and expertise accumulated through experience under a given set of economic circumstances.

This same process, however, may reduce managers' ability to adapt when economic conditions change. Repeated success reinforces established knowledge, decision-making heuristics, and organizational routines, gradually increasing reliance on approaches that have proven effective under prevailing conditions. While such specialization enhances efficiency when the environment remains relatively stable, it may also reduce managers' willingness or ability to revise existing beliefs and decision-making processes when circumstances change. As capabilities become increasingly refined, they may evolve into rigidities that constrain future adaptation, encouraging continued exploitation of established approaches rather than exploration of new ones (Leonard-Barton, 1992; Levinthal & March, 1993). Sustained success may therefore create a competence trap (Zollo & Winter, 2002), whereby managers continue relying on

capabilities developed under previous environmental conditions even after those conditions have materially changed (Wang et al., 2015). Consequently, managerial ability may become increasingly specialized to the economic environment in which it was developed, raising the possibility that managers who excel under one set of conditions may struggle when those conditions change materially.

The competence-trap literature has typically examined this adaptation problem in settings characterized by technological or competitive disruption, where firms must abandon established capabilities in response to innovation, changing customer preferences, or new competitive threats (Teece et al., 1997, 2016). These studies naturally emphasize technological discontinuities because they require organizations to revise established ways of operating. However, the underlying theoretical mechanism is considerably broader than technological disruption alone. Neither Leonard-Barton (1992) nor Wang et al. (2015) argue that competence traps arise because technology changes per se. Rather, competence traps emerge whenever managers continue relying on decision-making heuristics, routines, and capabilities that evolved under one set of environmental conditions after those conditions have materially changed. Technological change therefore represents one important manifestation of the theory, but it is not its defining feature. More generally, competence traps should arise whenever environmental changes alter the economic payoffs governing managerial decisions sufficiently to require meaningful revisions of previously successful decision-making processes.

We argue that unexpected monetary policy decisions provide precisely such an environment. Monetary policy is among the most pervasive determinants of firms' operating environments, influencing financing costs, credit availability, discount rates, aggregate demand, investment opportunities, and corporate financing decisions

(Bernanke & Gertler, 1995; Bernanke & Kuttner, 2005; Gertler & Karadi, 2015; Ottonello & Winberry, 2020). Although Federal Open Market Committee (FOMC) meetings are scheduled in advance, their unexpected policy components frequently generate substantial revisions to firms' economic environment. By driving up to half of the variation in aggregate economic output (Barakchian & Crowe, 2013), changes in monetary policy affect virtually every major business function by altering the profitability of investment projects, financing strategies, acquisition decisions, hiring plans, production schedules, inventory policies, capital budgeting, and broader resource-allocation decisions. Consequently, managers must reassess not only individual corporate decisions but also the assumptions and decision-making processes that underpin those decisions. In other words, unexpected monetary policy shocks alter the payoff structure facing managers, creating precisely the type of environmental change under which competence traps predict that previously successful capabilities may become less effective. Accordingly, we view monetary policy not as an analogy to technological disruption, but as an alternative manifestation of the same underlying adaptation problem.

Whether managerial ability remains valuable under such conditions remains an open empirical question. On the one hand, managers possessing superior judgment, greater cognitive flexibility, and stronger information-processing capabilities may be better equipped to interpret changing macroeconomic conditions and revise their decision-making accordingly (Helfat & Peteraf, 2003, 2015). Their accumulated expertise may therefore facilitate organizational adaptation by enabling firms to navigate monetary policy shocks without introducing unnecessary instability into their corporate decisions. In particular, more able managers may be better positioned to adjust the scale and financing of the firm while avoiding erratic or excessive changes in firm growth and

capital structure. Under this view, managerial ability should be associated not only with better outcomes following monetary policy shocks, but also with greater stability in the process through which firms adapt.

On the other hand, if managerial ability primarily reflects expertise accumulated under previous economic conditions, significant changes in the macroeconomic environment may reduce the effectiveness of precisely those routines and heuristics that previously generated superior performance. Such competence traps may make previously successful managers less effective when confronted with unfamiliar conditions, potentially producing greater instability as firms repeatedly reassess their growth and financing decisions. Under this view, firms led by managers previously regarded as highly capable need not navigate monetary policy shocks more smoothly than their peers, and may even experience more volatile subsequent adjustments.

Financial markets provide an immediate assessment of these competing predictions. Because FOMC announcements occur at well-defined points in time and their unexpected components are rapidly incorporated into asset prices (Kurov, 2010, 2012; Ozdagli & Weber, 2026), investors must immediately evaluate not only the direct implications of monetary policy but also managers' ability to navigate the new economic environment. If investors believe that managerial ability reflects genuine adaptability rather than simply success under previous economic conditions, firms led by more able managers should experience more favorable stock market reactions following monetary policy announcements. Conversely, if previously successful managerial capabilities become less valuable when the economic environment changes, the valuation premium associated with managerial ability should diminish following monetary policy shocks.

These competing perspectives also generate predictions about firms' subsequent corporate adjustment. If managerial ability facilitates adaptation, more able managers should enable firms to navigate changing monetary conditions more smoothly, limiting unnecessary fluctuations in firm growth and financing structure as they adjust to the new environment. If, instead, prior managerial success creates a competence trap, firms led by previously able managers should exhibit no such stability advantage following a change in monetary conditions. These arguments give rise to two related hypotheses concerning financial markets' immediate assessment of managerial ability and firms' subsequent adaptation to monetary policy.

Hypothesis 1. Firms managed by more able managers experience more favorable stock market reactions to monetary policy shocks.

Hypothesis 2. Following monetary policy shocks, firms managed by more able managers exhibit greater stability in firm growth and capital structure adjustments.

3. Managerial Ability Data

We use the publicly available data on the decomposition of firm efficiency into a managerial ability component and a firm-fundamentals-driven component, which we refer to as structural efficiency. This dataset is kindly made available by Demerjian et al. (2012). The authors employ a two-step procedure to construct their measures.

In the first step, they use Data Envelopment Analysis (DEA), a widely used non-parametric linear programming method (Førsund & Sarafoglou, 2002; Khezrimotlagh et al., 2019), to compute an overall efficiency score for each firm-year observation. DEA evaluates how effectively a firm utilizes its resources to generate sales revenue relative to the best-performing firms in the same year. Firms that lie on the "best practice frontier"

receive an efficiency score of one, while less efficient firms receive scores between zero and one, indicating the proportion of potential output they achieve given their resource inputs. In their DEA model, Demerjian et al. (2012) treat sales revenue as the output to be maximized and include multiple inputs that reflect the key resources available to management: cost of goods sold, selling, general, and administrative expenses, net property, plant, and equipment, operating leases, research and development expense, intangibles, and goodwill. These inputs collectively capture the firm's physical, financial, and intangible resources, and the resulting DEA score represents the firm's ability to convert these resources into revenues compared to its most efficient peers.

In the second step, Demerjian et al. (2012) separate the portion of total efficiency attributable to managerial ability from the portion driven by structural firm characteristics. They recognize that a firm's position on the efficiency frontier may reflect not only managerial skill but also factors beyond managers' control, such as scale economies, market position, or operational complexity. To adjust for these factors, they regress the total efficiency scores on a set of firm-level variables that capture structural and environmental determinants of efficiency, including firm size, market share, cash flow position, business complexity (as measured by the number of business segments), foreign currency exposure, and the level of industry competition. The residual from this regression, i.e., the component of efficiency unexplained by firm characteristics, is interpreted as the managerial ability score. This residual isolates how much better or worse a manager performs relative to peers at similarly situated firms with comparable resources and operating conditions.

Our primary variable of interest is the managerial ability measure. Demerjian et al. (2012) argue that this residual captures managers' effectiveness in transforming the

firm's available resources into revenues after accounting for differences in firms' underlying operating environments. The remaining predictable component of total efficiency, which we refer to as structural efficiency, reflects the portion attributable to relatively persistent firm characteristics rather than manager-specific performance. Although managers may gradually influence some of these structural attributes over long horizons, the decomposition cleanly distinguishes the efficiency associated with the firm's underlying characteristics from that attributable to the manager.

4. The Firm's Stock Price Reaction to FOMC Announcements

4.1. Baseline results

We begin our empirical analysis with an event study examining whether managerial ability influences the stock market's reassessment of firms following Federal Open Market Committee (FOMC) announcements. Specifically, we investigate whether investors place a higher value on firms led by more able managers when unexpected monetary policy decisions alter firms' future prospects. Before presenting the main results, we first describe the monetary policy events and their associated surprises, as well as the firm-level variables included in the analysis. Our sample comprises 244 FOMC monetary policy announcements between 1994 and 2022. For terminological clarity, we distinguish between monetary surprises and monetary shocks. Monetary surprises refer to the high-frequency announcement-based changes used in our event study analysis, whereas monetary shocks—defined later—capture lower-frequency measures that we use to examine how firms' investment and financing decisions respond to monetary policy over time.

To quantify monetary policy surprises, we follow the standard approach of measuring the change in the three-month-ahead Treasury yield over a narrow window

surrounding the FOMC announcement, specifically from 10 minutes before to 20 minutes after the policy statement. An increase (decrease) in the Treasury yield over this interval reflects a contractionary (expansionary) monetary surprise, indicating that financial markets interpreted the announcement as tighter (looser) than previously expected. These high-frequency surprises are obtained from Jarociński and Karadi (2020). Figure 1 plots the monetary policy surprises over the 1994–2022 sample period. Contractionary surprises are shown above the zero line, while expansionary surprises are shown below it.

(Insert Figure 1 about here)

Our firm-level dataset comprises 1,351 non-financial, non-utility U.S. firms for which managerial ability and efficiency scores are available from the online appendix of Demerjian et al. (2012). We augment these data with accounting information from COMPUSTAT and stock return data from CRSP. The final sample consists of 151,282 firm-meeting observations, each corresponding to a firm's stock market response to a specific FOMC announcement.

Our primary dependent variables are cumulative abnormal returns (CARs) measured over the announcement day (day 0) and the one-day and two-day post-announcement windows following FOMC announcements. Abnormal returns are calculated relative to expected returns estimated using the Capital Asset Pricing Model (CAPM) over the estimation window from 250 to 4 trading days before each announcement. Our conclusions are unchanged when expected returns are instead estimated using the Fama and French (1993) three-factor model or the Carhart (1997) four-factor model. Table 1 reports descriptive statistics for the variables included in the event study, including managerial ability, structural efficiency, firm size, leverage, prior

performance, and the text-based debt constraint measure of Linn and Weagley (2024). These statistics summarize the characteristics of our sample before turning to the regression analysis.

(Insert Table 1 about here)

Table 2 reports regression models examining firms' stock price reactions to monetary policy surprises, with a main focus on the interaction between monetary surprises, separated into expansionary and contractionary ones, and managerial ability. In these specifications, $Contractionary\ Surprise$ is defined as the standardized positive FOMC Treasury yield surprise, obtained by dividing the raw positive (i.e., contractionary) yield surprise by its standard deviation. $Expansionary\ Surprise$ is defined analogously as the absolute value of negative FOMC Treasury yield surprises, likewise standardized by its standard deviation. The dependent variable in these models, $CAR(0, +d)$, denotes cumulative stock returns over *d+1* days, i.e., the day of the FOMC announcement (day 0) and the *d* days that follow.

$$\begin{aligned} CAR(0,+d)_{i,t} = {} & b1.Expansionary\ Surprise_t \\ & + b2.Expansionary\ Surprise_t \times Managerial\ Ability_{i,t} \\ & + b3.Contractionary\ Surprise_t \\ & + b4.Contractionary\ Surprise_t \times Managerial\ Ability_{i,t} \\ & + f(Control\ Factors) + g(Fixed\ Effects) + \epsilon_{i,t} \end{aligned} \quad (1)$$

The results reported in Table 2 provide robust evidence supporting our first prediction that financial markets assign greater value to firms led by more able managers following monetary policy surprises. In the case of contractionary monetary policy surprises, managerial ability partially offsets the negative valuation effects associated with unexpected monetary tightening. By contrast, the positive market reaction to

expansionary monetary policy surprises is magnified for firms led by highly able managers. Economically, a one-standard-deviation contractionary monetary policy surprise reduces the baseline firm's cumulative abnormal return (CAR) by approximately 0.21%, with higher managerial ability partially offsetting this decline. Conversely, following a one-standard-deviation expansionary surprise, moving from the first to the third quartile of managerial ability increases the firm's CAR by up to 0.20 percentage points (0.4×0.5 in Model 5).

(Insert Table 2 about here)

4.2. Robustness

4.2.1. Robustness to the Fed information effect

A key challenge in identifying the effects of monetary policy surprises is the presence of the Federal Reserve information effect. Monetary policy announcements convey not only unexpected policy actions but also information about the Federal Reserve's assessment of current and future economic conditions (Adra et al., 2025; Faust et al., 2004; Nakamura & Steinsson, 2018). Consequently, an unexpected increase in policy rates may simultaneously signal tighter monetary policy, which is expected to reduce equity valuations, and a more optimistic assessment of economic fundamentals, which may increase stock prices (Jarociński & Karadi, 2020; Lunsford, 2020). Likewise, an unexpected monetary easing may reveal weaker-than-anticipated economic conditions despite representing a more accommodative policy stance. As a result, the observed market reaction reflects both the conventional effect of monetary policy and the information revealed by the Federal Reserve, potentially confounding the interpretation of monetary policy surprises.

To address this concern, Table 3 re-estimates our baseline specifications using the alternative identification strategy proposed by Jarociński and Karadi (2020). Their approach isolates the conventional monetary policy component by classifying as monetary policy surprises only those FOMC announcements in which equity prices move in the direction conventionally predicted by monetary policy within a narrow announcement window, thereby excluding announcements that are likely to be dominated by the Federal Reserve's information effect. Reassuringly, our results remain qualitatively unchanged. The interactions between managerial ability and both contractionary and expansionary monetary policy surprises retain the same signs, remain broadly similar in magnitude, and continue to be statistically significant, indicating that our findings are not driven by the informational content of Federal Reserve announcements.

The results in Table 3 reinforce the evidence presented in Table 2, indicating that managerial ability plays an important role in shaping firms' stock market responses to monetary policy surprises. The main conclusions remain unchanged when the event window is extended, suggesting that the findings are not sensitive to the choice of event window. A notable difference is that, for the three-day cumulative abnormal return (CAR), the positive effect of expansionary monetary policy surprises becomes conditional on managerial ability. Specifically, expansionary surprises generate significantly more favorable stock market reactions only for firms led by more able managers, whereas no comparable effect is observed for firms with lower managerial ability. Overall, these findings provide further evidence that financial markets value managerial ability because it enhances firms' capacity to adapt to changing macroeconomic conditions.

(Insert Table 3 about here)

4.2.2. Dynamic effects after exogenous managerial turnover

While the preceding analyses establish a strong association between managerial ability and firms' responses to monetary policy surprises, concerns may remain that managerial ability is correlated with unobserved firm characteristics rather than exerting a causal influence on investors' expectations. To address this concern, we exploit plausibly exogenous changes in managerial ability arising from CEO deaths (Fee et al., 2013) using the dataset available by Gentry et al. (2021). Because CEOs play a central role in shaping firms' strategic direction, decision-making processes, and organizational culture (Adra et al., 2026; Benmelech & Frydman, 2015; Crossland et al., 2014), the appointment of a new CEO provides a natural setting in which to examine whether changes in managerial ability alter investors' assessment of firms' capacity to respond to changing macroeconomic conditions.

To maximize the likelihood that the incoming CEO has fully influenced the firm's strategic direction and decision-making processes, we restrict the analysis to Federal Open Market Committee (FOMC) meetings occurring during the second full year following the CEO's appointment. This timing also allows managerial ability to be measured after the incoming CEO has had sufficient time to shape firm operations, enabling us to identify changes in managerial ability relative to the deceased CEO rather than relying on contemporaneous or inherited firm characteristics. We then examine whether improvements or deteriorations in managerial ability are associated with corresponding changes in stock market reactions to monetary policy surprises. Our event-study dataset is matched with the part of the database made available by Gentry et al. (2021) that identified the events of CEO death. Overall, our sample comprises 81 turnover events associated with CEO death. We summarize our approach in Figure 2.

(Insert Figure 2 about here)

Our estimations on the resulting subsample follow the specification:

$$\begin{aligned} CAR(0,+d)_{i,t} = {} & b1.\,Expansionary\ Surprise_t \\ & + b2.\,Expansionary\ Surprise_t \times \Delta Managerial\ Ability_{i,t} \\ & + b3.\,Contractionary\ Surprise_t \\ & + b4.\,Contractionary\ Surprise_t \times \Delta Managerial\ Ability_{i,t} \\ & + f(Control\ Factors) + g(Fixed\ Effects) + \epsilon_{i,t} \end{aligned} \tag{2}$$

where $\Delta Managerial\ Ability_{i,t}$ is the difference between the managerial ability score of the incoming CEO in the first full year of the CEO's tenure and the managerial ability score of the preceding CEO in the final full year of the predecessor's tenure. This measure is scaled by its standard deviation in our sample (a value of 0.11).

The evidence in Table 4 supports the view that the effect of managerial ability on firms' responses to monetary policy surprises is highly dynamic. Changes in managerial ability are accompanied by corresponding changes in investors' assessment of firms' capacity to navigate changing macroeconomic conditions. Firms experiencing an improvement in managerial ability following CEO turnover receive more favorable stock market reactions to monetary policy surprises, whereas firms experiencing a decline in managerial ability receive less favorable market responses. In particular, conditional on a standardized monetary shock, a one-standard-deviation increase in managerial ability difference drives shareholders' gains by roughly 0.8%, offsetting the losses from contractionary surprises and expanding the gains from expansionary surprises.

These findings suggest that equity investors continuously update their expectations regarding firms' adaptive capacity as managerial quality evolves. More broadly, the results reinforce the interpretation that, from the perspective of equity

investors, managerial ability is a key determinant of a firm's capacity to adapt to changing macroeconomic conditions, rather than merely a proxy for persistent differences in firm characteristics or organizational quality that are unrelated to changes in leadership.

(Insert Table 4 about here)

4.2.3. Additional robustness checks

We conduct two additional robustness tests, reported in Appendix 2. First, we consider whether our findings may reflect differences in corporate governance rather than managerial ability. Firms with more independent boards may be better governed and may also be more likely to attract able managers, potentially confounding the effect attributed to managerial ability. At the same time, greater board independence need not necessarily facilitate adaptation to economic shocks. During periods of rapid change, greater board involvement may constrain managerial discretion or introduce competing perspectives when firms require clear and coherent direction. We therefore augment our baseline specification by interacting both expansionary and contractionary monetary policy surprises with an indicator of strong board independence. As shown in Table A2.1, the managerial ability effects remain robust, while the interactions with board independence are negative. Thus, stronger board independence does not account for the favorable market response associated with managerial ability and, if anything, is associated with less favorable responses to monetary policy shocks.

Second, we address common time-varying factors, consistent with the use of time fixed effects in firm-level analyses (Li et al., 2025; Li et al., 2026; Pu et al., 2025). Specifically, we replace year fixed effects with FOMC meeting fixed effects, thereby absorbing announcement-specific factors common to all firms exposed to the same meeting, in line with related research on monetary policy transmission (Gürkaynak et al.,

2022; Döttling and Ratnovski, 2023). The main results in Table A2.2 remain unchanged under this more demanding specification.

5. Evidence from Firm's Adaptive Response

5.1. Introducing the panel data setting: monetary shocks and firm-related variables

To examine whether the market's assessment of managerial ability is subsequently reflected in firms' responses to monetary policy shocks, we shift our analysis to a firm-quarter panel that examines corporate investment and financing decisions following changes in monetary policy. We impose the same firm-level data requirements as in Section 4 but apply them at the quarterly frequency. Because managerial ability is measured annually, we assign the most recently available end-of-year managerial ability measure to each firm-quarter observation. Table 5 presents descriptive statistics for the variables used in the panel analysis. Unlike the event-study analysis, which relies on high-frequency monetary policy surprises to identify investors' immediate responses to FOMC announcements, the panel analysis requires a measure of monetary policy innovations that captures their broader economic effects over time. Accordingly, we employ the unified monetary policy shock series developed by Bu et al. (2021), which is specifically designed for monthly and quarterly analyses and provides a consistent measure of both conventional and unconventional monetary policy shocks.

(Insert Table 5 about here)

The Bu et al. (2021) shocks are estimated using a two-step Fama–MacBeth–style procedure (Fama & MacBeth, 1973) that exploits the common response of the entire Treasury yield curve to FOMC announcements. In the first step, changes in zero-coupon Treasury yields across maturities (from one to thirty years) around FOMC meetings are

regressed on a benchmark policy indicator—normalized to the two-year Treasury yield—to estimate each maturity's sensitivity to an unobserved monetary policy shock. This step incorporates a heteroskedasticity-based instrumental-variables approach to purge non-monetary influences, including central bank information effects.

In the second step, these estimated sensitivities are used in cross-sectional regressions to extract the common component of yield movements on each announcement date. The resulting time series of coefficients constitutes the monetary policy shock measure. By using the full maturity spectrum of the yield curve and a partial least squares framework, this approach isolates policy innovations that are largely unpredictable, orthogonal to contemporaneous macroeconomic news, and free of significant information effects. Figure 3 presents the quarterly levels of these shocks from 1994 to 2020, the last date for which these shocks are available.

(Insert Figure 3 about here)

5.2. The firm's growth response to monetary shocks

We next examine how firms adjust following monetary policy shocks and whether managerial ability shapes the stability of this adjustment over time. Rather than focusing on a particular investment margin, such as capital expenditure, we examine growth in total assets. This provides a broader measure of firm growth and allows us to capture the overall pattern through which the scale of the firm evolves following a monetary policy shock.

Our central prediction concerns the stability of this adjustment. Monetary policy shocks alter firms' financing conditions and investment opportunities, requiring managers to reassess firms' growth decisions. Such adjustment need not follow a smooth

path. Firms may initially expand or contract before subsequently reversing these decisions as managers reassess the implications of the shock. If managerial ability facilitates adaptation to changing economic conditions, firms led by more able managers should navigate this process more smoothly, exhibiting fewer pronounced fluctuations and reversals in their growth trajectories following monetary policy shocks.

To examine this prediction, we employ local projections in a panel data setting (Jordà et al., 2020). Rather than imposing a particular dynamic structure on the data, local projections estimate the response of the outcome variable separately at each horizon, allowing the effects of monetary policy shocks to be traced flexibly over subsequent quarters (Cloyne et al., 2023; Ottonello & Winberry, 2020). This approach is particularly well suited to our setting because it allows us to compare the post-shock growth trajectories of firms led by managers with different levels of ability.

For each horizon $h = 1, \dots, 12$, we measure firm growth as the change in total assets between quarters $t + h - 1$ and $t + h$. Specifically, asset growth is calculated as total assets in quarter $t + h$ relative to total assets in quarter $t + h - 1$, minus one. We estimate the following specification:

$$\frac{Assets_{i,t+h}}{Assets_{i,t+h-1}} = b1.Expansionary\ Shock_t + b2.Contractionary\ Shock_t + f(Control\ Factors) + g(Fixed\ Effects) + \epsilon_{i,t} \quad (3)$$

The dependent variable captures firm i's asset growth at horizon h following the monetary policy shock. $Expansionary\ Shock_t$ and $Contractionary\ Shock_t$ are the standardized expansionary and contractionary monetary policy shocks of Bu et al. (2021), respectively. We follow Ottonello and Winberry (2020) by controlling for time-

sector fixed effects in the panel setting, while standard errors are clustered at the firm level. Equation (3) is estimated for horizons from one to 12 quarters and separately for firms in the top and bottom quartiles of the managerial ability distribution. This allows us to compare the evolution and stability of firm growth following monetary policy shocks across high- and low-managerial-ability firms.

Figure 4 presents the resulting impulse responses. A clear difference emerges in the pattern of adjustment across the two managerial ability groups. Following both contractionary and expansionary monetary policy shocks, firms led by high-ability managers exhibit comparatively smooth growth trajectories, with their responses remaining relatively stable over subsequent quarters. Firms led by low-ability managers, by contrast, exhibit larger fluctuations in asset growth and more pronounced reversals in the direction of these movements. The contrast is particularly apparent at intermediate horizons, where the growth responses of low-ability firms fluctuate considerably while those of high-ability firms remain comparatively stable.

These findings suggest that managerial ability shapes the stability of firms' growth responses rather than simply determining whether firms expand or contract more strongly following a monetary policy shock. More able managers appear to enable firms to navigate changing monetary conditions along a smoother growth path, avoiding the pronounced fluctuations and reversals observed among firms led by less able managers. Such stability can limit potentially costly adjustments in firms' expansion and provides a potential explanation for the favorable valuation effects of managerial ability documented in our event-study analysis.

(Insert Figure 4 about here)

5.3. The leverage response to monetary shocks

We next examine whether the greater stability associated with managerial ability extends to firms' financing decisions. Monetary policy shocks alter both the cost and availability of external finance, requiring firms to reassess how their assets are financed. Changes in capital structure may therefore represent an important dimension of firms' adaptation to changing monetary conditions. As with firm growth, however, successful adaptation need not imply larger or more rapid changes in financing. Instead, more able managers may enable firms to navigate monetary policy shocks while avoiding pronounced fluctuations and reversals in their financing decisions.

Our central prediction therefore concerns the stability of firms' capital structure following monetary policy shocks. Firms led by less able managers may repeatedly revise their financing decisions as they respond to changing conditions and reassess the implications of the shock. By contrast, if managerial ability facilitates adaptation, firms led by more able managers should exhibit smoother capital structure trajectories, with fewer pronounced changes and subsequent reversals following both expansionary and contractionary monetary policy shocks.

To examine this prediction, we extend the local projection framework used in the previous subsection to firms' leverage decisions. We measure leverage at each horizon using liabilities scaled by total assets in the preceding quarter. For horizons $h = 1, \dots, 12$, we estimate the following specification separately for firms in the top and bottom quartiles of the managerial ability distribution:

$$\frac{Liabilities_{i,t+h}}{Assets_{i,t+h-1}}$$

$$= b1.Expansionary\ Shock_t + b2.Contractionary\ Shock_t + f(Control\ Factors) + g(Fixed\ Effects) + \epsilon_{i,t} \quad (4)$$

The dependent variable captures the firm's financing position at horizon h, measured as liabilities at $t + h$ relative to total assets in the preceding quarter.

Figure 5 presents the resulting impulse responses. The pattern closely mirrors the firm-growth results in Figure 4. Following both contractionary and expansionary monetary policy shocks, the leverage responses of firms led by high-ability managers follow a comparatively smooth trajectory over subsequent quarters. In contrast, firms led by low-ability managers exhibit considerably larger fluctuations and more pronounced reversals in their leverage responses. The difference is especially apparent at intermediate horizons, including the sharp movements among low-ability firms around the fourth quarter following contractionary shocks and the seventh quarter following expansionary shocks. The corresponding responses among high-ability firms remain considerably more stable.

Taken together with the firm-growth results, Figure 5 suggests that the greater stability associated with managerial ability extends across two central dimensions of corporate adjustment. More able managers appear to enable firms not only to maintain smoother growth trajectories, but also to navigate changing monetary conditions without repeatedly making large changes to their financing structure. The evidence therefore supports the view that managerial ability facilitates organizational adaptation by limiting potentially costly fluctuations in both firms' growth and capital structure decisions.

(Insert Figure 5 about here)

6. Conclusion

This paper examines whether managerial ability retains its value when firms face major changes in their economic environment. Using monetary policy shocks as our empirical setting, we find that firms led by more able managers experience more favorable stock market reactions to both expansionary and contractionary monetary policy surprises. Exploiting plausibly exogenous changes in managerial ability following CEO deaths provides evidence consistent with a causal interpretation. We further show that the value of managerial ability extends beyond financial markets' immediate assessment. Following monetary policy shocks, firms led by more able managers exhibit less volatile growth and capital structure adjustments. Managerial ability therefore appears to facilitate adaptation not through more aggressive corporate responses, but through greater stability, allowing firms to adjust to changing monetary conditions while avoiding costly fluctuations in their investment and financing decisions.

These findings speak to a broader question concerning the value of accumulated managerial expertise in changing environments. While prior experience, established routines, and previously successful practices can potentially become sources of rigidity when conditions change, our evidence suggests that managerial ability helps firms overcome rather than reinforce such competence traps. More able managers appear better positioned to translate their existing expertise into stable adaptation when the economic environment changes, and financial markets recognize this capacity. Our findings therefore identify managerial ability as an important source of heterogeneity in the transmission of monetary policy while also highlighting a broader role for managerial ability: its value lies not only in improving firm performance under prevailing conditions,

but also in helping organizations navigate disruptions without destabilizing their corporate decisions.

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Appendix 1: Variables in the event study

Variable	Description	Source
$CAR(0, +d)$	The Cumulative Abnormal Return (CAR) based on the CAPM model covering day 0 of the FOMC meeting and the subsequent d days after the meeting, inclusive.	Authors' Estimations + CRSP
Expansionary Surprise	The absolute value of the standardized monetary surprise, calculated as the change in the three-month-ahead treasury rates, around the FOMC announcement when it is lower than 0%, and 0 otherwise.	Marek Jarocinski's Website
Contractionary Surprise	The absolute value of the standardized monetary surprise, calculated as the change in the three-month-ahead treasury rates, around the FOMC announcement when it is higher than 0%, and 0 otherwise.	Marek Jarocinski's Website
Managerial Ability	The Demerjian et al. (2012) measure of managerial ability based on the latest available yearly data.	Professor Peter Demerjian's website
Structural Efficiency	The Demerjian et al. (2012) measure of structural efficiency based on the latest available yearly data.	Professor Peter Demerjian's website
Investment Rate	The firm's annual capital expenditures as a percentage of total assets, based on financial statements of the prior calendar year.	COMPUSTAT
Assets	The value of recorded assets for each firm, in millions of 2015 dollars, based on the latest financial statements of the prior calendar year.	COMPUSTAT
RoA	The firm's net income divided by assets, multiplied by 100, based on the latest financial data from the prior calendar year.	COMPUSTAT
Debt	The total debt as a percentage of the total assets based on the latest financial data from the prior calendar year.	COMPUSTAT
Intangibles Percentage	The quarterly level of intangibles (total R&D + 0.3×Selling, General, and Administrative Expenses) divided by the firm's total assets, multiplied by 100.	COMPUSTAT
No Dividends	Dummy=1 if the firm did not pay dividends in the last calendar year, and 0 otherwise.	COMPUSTAT
Board Independence	Dummy=1 if the latest reported percentage of independent board members exceeds the 75th percentile in the aggregate BoardEx database, and 0 otherwise.	BoardEx
Debt Constraint	The text-based debt constraint index of Linn and Weagley (2024).	Linn and Weagley (2024)
Unemployment	The level of the U.S. unemployment rate at the quarter.	U.S. Bureau of Labor Statistics, Unemployment Rate [UNRATE], retrieved from FRED, Federal Reserve Bank of St. Louis.
CPI	The Consumer Price Index at the end of the quarter.	U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items in U.S. City Average [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis

Notes: This table presents the name, description, and source of each variable in our event-study analysis.

Appendix 2: Additional robustness checks

This appendix presents two additional robustness tests designed to address alternative explanations and strengthen the identification of our event-study results. The first examines whether the documented role of managerial ability reflects differences in firms' corporate governance environments, while the second introduces FOMC meeting fixed effects to absorb announcement-specific factors common to all firms.

A2.1. Controlling for board independence

One potential concern is that managerial ability may be correlated with the quality of firms' corporate governance. Firms with stronger governance structures may be more likely to attract able managers while also responding differently to monetary policy shocks. To address this possibility, we augment our baseline event-study specification by interacting both expansionary and contractionary monetary policy surprises with an indicator capturing strong board independence. This allows the effect of monetary policy surprises to vary with firms' governance environments while retaining the interactions between monetary policy surprises and managerial ability.

Table A2.1 reports the results. The main interactions between managerial ability and expansionary and contractionary monetary policy surprises remain consistent with our baseline findings after accounting for board independence. The results therefore provide reassurance that the documented role of managerial ability is not simply capturing differences in board independence across firms.

Table A2.1: Robustness to board independence

Model	(1)	(2)	(3)	(4)	(5)	(6)
Independent\Dependent	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+2)$	$CAR(0,+2)$	$CAR(0,+2)$
Contractionary Surprise	-0.123***	-0.121***	-0.122***	-0.173***	-0.168***	-0.169***
	(0.046)	(0.046)	(0.046)	(0.057)	(0.057)	(0.057)
Contractionary Surprise × *Managerial Ability*	0.153**	0.188**	0.207**	0.220**	0.211**	0.243**
	(0.076)	(0.087)	(0.086)	(0.106)	(0.107)	(0.106)
Contractionary Surprise × *Board Independence*	-0.222***	-0.208**	-0.214**	-0.519***	-0.510***	-0.512***
	(0.086)	(0.087)	(0.086)	(0.106)	(0.107)	(0.106)
Expansionary Surprise	0.306***	0.301***	0.300***	0.367***	0.359***	0.360***
	(0.047)	(0.047)	(0.047)	(0.057)	(0.058)	(0.057)
Expansionary Surprise × *Managerial Ability*	0.310***	0.359***	0.307***	0.436***	0.481***	0.431***
	(0.091)	(0.092)	(0.091)	(0.112)	(0.114)	(0.112)
Expansionary Surprise × *Board Independence*	-0.375***	-0.366***	-0.362***	-0.647***	-0.631***	-0.634***
	(0.096)	(0.097)	(0.096)	(0.118)	(0.120)	(0.118)
Control Factors	YES	YES	YES	YES	YES	YES
Firm Effects	NO	YES	NO	NO	YES	NO
Sector Effects	NO	NO	YES	NO	NO	YES
Year Effects	YES	YES	YES	YES	YES	YES
N	151,282	151,282	151,282	151,282	151,282	151,282
R^2	0.01	0.01	0.01	0.01	0.01	0.01

Standard errors are clustered at the firm level, and clustering at the industry level yields similar results. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

A2.2. FOMC meeting fixed effects

Our baseline event-study specifications include year fixed effects to account for common temporal variation. As an additional robustness test, we replace these year fixed effects with FOMC meeting fixed effects, represented by a separate indicator variable for each monetary policy meeting. This constitutes a more demanding specification because meeting fixed effects absorb all observed and unobserved announcement-specific factors that are common across firms around a given FOMC announcement. Consequently, the effects of managerial ability are identified from cross-sectional differences among firms exposed to the same monetary policy announcement.

Table A2.2 reports the results. The interactions between managerial ability and both expansionary and contractionary monetary policy surprises remain consistent with our main findings after the inclusion of meeting fixed effects. Our conclusions are therefore robust to absorbing announcement-specific factors common across firms, providing additional reassurance that the results reflect cross-sectional differences associated with managerial ability rather than characteristics of particular FOMC announcements.

Table A2.2: Robustness to FOMC meeting fixed effects

Model	(1)	(2)	(3)	(4)	(5)	(6)
Independent\Dependent	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+2)$	$CAR(0,+2)$	$CAR(0,+2)$
Contractionary Surprise	-0.152*	-0.151*	-0.191**	-0.165*	-0.216**	-0.205**
	(0.090)	(0.090)	(0.091)	(0.099)	(0.101)	(0.101)
Contractionary Surprise × *Managerial Ability*	0.198**	0.192**	0.192**	0.211**	0.224**	0.225**
	(0.085)	(0.086)	(0.085)	(0.105)	(0.106)	(0.105)
Expansionary Surprise	0.167	0.167	0.167	0.183	0.184	0.184
	(0.178)	(0.177)	(0.177)	(0.168)	(0.168)	(0.168)
Expansionary Surprise × *Managerial Ability*	0.317***	0.365***	0.314***	0.446***	0.489***	0.441***
	(0.090)	(0.091)	(0.090)	(0.111)	(0.113)	(0.111)
Control Factors	YES	YES	YES	YES	YES	YES
Firm Effects	NO	YES	NO	NO	YES	NO
Sector Effects	NO	NO	YES	NO	NO	YES
Meeting Effects	YES	YES	YES	YES	YES	YES
N	151,282	151,282	151,282	151,282	151,282	151,282
R^2	0.01	0.01	0.01	0.01	0.01	0.01

Standard errors are clustered at the firm level, and clustering at the industry level yields similar results. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

Table 1: Descriptive statistics

This table presents the key descriptive statistics of the variables used in our event-study analysis. For each variable, we report the number of available observations, the mean, 25th percentile, median, 75th percentile, and standard deviation.

Variable	N	Mean	25th Percentile	Median	75th Percentile	SD
$CAR(0,+1)$	151,282	0.06	-1.73	-0.08	1.62	4.59
$CAR(0,+2)$	151,282	0.11	-2.11	-0.08	2.05	5.60
Expansionary Surprise	151,282	0.35	0.00	0.00	0.30	1.01
Contractionary Surprise	151,282	0.46	0.00	0.00	0.50	1.05
Managerial Ability	151,282	0.01	-0.20	-0.02	0.21	0.21
Structural Efficiency	151,282	0.37	0.31	0.36	0.42	0.10
Investment Rate	151,282	5.46	2.03	3.76	6.79	5.92
Assets	151,282	9541.31	473.49	1499.59	5239.63	38308.60
RoA	151,282	0.99	0.31	1.23	2.29	4.27
Debt	151,282	53.67	37.08	52.71	66.62	49.85
Intangibles Percentage	151,282	2.69	0.78	1.91	3.70	3.08
No Dividends	151,282	0.50	0.00	0.00	1.00	0.50
Board Independence	151,282	0.27	0.00	0.00	1.00	0.44
Debt Constraint	151,282	0.14	-0.27	0.14	0.51	0.63
Unemployment	151,282	5.58	4.40	5.40	6.00	1.58
CPI	151,282	202.90	174.60	203.10	234.72	35.38

Table 2: The firm's stock price reaction to FOMC announcements

This table reports six models examining firms' stock market reactions to monetary policy surprises announced at FOMC meetings, with particular emphasis on the role of managerial ability. The dependent variable is the cumulative abnormal return (CAR), measured over alternative event windows covering the announcement day and the following trading day in Models (1)–(3), and the three-day window covering the announcement day and the following two trading days in Models (4)–(6). All specifications include a comprehensive set of fixed effects and control variables. Standard errors are clustered at the firm level, and clustering at the industry level yields similar results. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix 1.

Model	(1)	(2)	(3)	(4)	(5)	(6)
Independent\Dependent	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+2)$	$CAR(0,+2)$	$CAR(0,+2)$
Contractionary Surprise	-0.207***	-0.207***	-0.207***	-0.186***	-0.187***	-0.186***
	(0.013)	(0.013)	(0.013)	(0.016)	(0.016)	(0.016)
Contractionary Surprise × *Managerial Ability*	0.258***	0.292***	0.262***	0.209**	0.232**	0.213**
	(0.086)	(0.087)	(0.086)	(0.106)	(0.107)	(0.106)
Expansionary Surprise	0.133***	0.133***	0.133***	0.169***	0.169***	0.110***
	(0.016)	(0.016)	(0.016)	(0.019)	(0.019)	(0.019)
Expansionary Surprise × *Managerial Ability*	0.318***	0.368***	0.315***	0.449***	0.499***	0.444***
	(0.091)	(0.092)	(0.091)	(0.112)	(0.114)	(0.112)
Managerial Ability	-0.180*	-0.361***	-0.153	-0.139	-0.306*	-0.112
	(0.096)	(0.128)	(0.099)	(0.119)	(0.158)	(0.122)
Structural Efficiency	-0.661***	-0.181	-0.734***	-0.131	0.791**	-0.057
	(0.206)	(0.311)	(0.230)	(0.254)	(0.383)	(0.283)
ln(*Assets*)	0.010	0.013	0.023*	-0.045***	-0.071**	-0.041***
	(0.012)	(0.029)	(0.013)	(0.015)	(0.036)	(0.015)
Investment Rate	-0.001	-0.002	0.003	0.002	-0.001	0.004
	(0.002)	(0.004)	(0.003)	(0.003)	(0.005)	(0.003)
Debt	0.001	0.002**	0.001	0.000	0.001	0.000
	(0.000)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
RoA	-0.016***	-0.017***	-0.016***	-0.030***	-0.031***	-0.031***
	(0.003)	(0.003)	(0.003)	(0.003)	(0.004)	(0.003)
No Dividends	0.023	-0.064	0.008	0.045	-0.060	0.020
	(0.024)	(0.042)	(0.025)	(0.030)	(0.052)	(0.031)
Intangibles Percentage	0.004	-0.012	0.005	-0.009	-0.015	-0.005
	(0.005)	(0.008)	(0.005)	(0.006)	(0.010)	(0.006)
Board Independence	0.015	0.046	-0.006	0.004	0.062	-0.002
	(0.024)	(0.032)	(0.026)	(0.030)	(0.039)	(0.031)
Debt Constraint	0.039**	0.052**	0.041**	0.049**	0.053*	0.054**
	(0.018)	(0.025)	(0.019)	(0.022)	(0.031)	(0.023)
Unemployment	0.325	0.338	0.336	1.391***	1.400***	1.395***
	(0.418)	(0.420)	(0.418)	(0.515)	(0.518)	(0.515)
ln(*CPI*)	-0.344	-0.630	-0.360	0.984	0.911	0.975
	(0.699)	(0.725)	(0.700)	(0.862)	(0.895)	(0.863)
Firm Effects	NO	YES	NO	NO	YES	NO
Sector Effects	NO	NO	YES	NO	NO	YES
Year Effects	YES	YES	YES	YES	YES	YES
N	151,282	151,282	151,282	151,282	151,282	151,282
R^2	0.01	0.01	0.01	0.01	0.01	0.01

Table 3: Initial effects with alternative monetary surprises

The specifications follow the same approach as Table 2, with one key difference: expansionary and contractionary surprises are identified using the method of Jarociński and Karadi (2020). Under this approach, only surprises that generate an opposite movement in the S&P 500 within the 30 minutes surrounding the FOMC meeting are classified as conventional monetary surprises, thereby excluding the Federal Reserve's informational effect. The Jarociński and Karadi (2020) surprises are also standardized. All models include a comprehensive set of fixed effects and control variables. Standard errors are clustered at the firm level, and clustering at the industry level yields similar results. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

Model	(1)	(2)	(3)	(4)	(5)	(6)
Independent\Dependent	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+2)$	$CAR(0,+2)$	$CAR(0,+2)$
JK Contractionary Surprise	-0.180***	-0.180***	-0.180***	-0.176***	-0.177***	-0.176***
	(0.013)	(0.013)	(0.013)	(0.016)	(0.016)	(0.016)
JK Contractionary Surprise × *Managerial Ability*	0.216**	0.310***	0.318***	0.222**	0.259**	0.323***
	(0.087)	(0.088)	(0.087)	(0.107)	(0.108)	(0.107)
JK Expansionary Surprise	0.063***	0.063***	0.063***	-0.023	-0.023	-0.023
	(0.015)	(0.015)	(0.015)	(0.019)	(0.019)	(0.019)
JK Expansionary Surprise × *Managerial Ability*	0.355***	0.393***	0.351***	0.386***	0.422***	0.379***
	(0.091)	(0.092)	(0.092)	(0.113)	(0.114)	(0.113)
Control Factors	YES	YES	YES	YES	YES	YES
Firm Effects	NO	YES	NO	NO	YES	NO
Sector Effects	NO	NO	YES	NO	NO	YES
Year Effects	YES	YES	YES	YES	YES	YES
N	151,282	151,282	151,282	151,282	151,282	151,282
R^2	0.02	0.01	0.01	0.01	0.01	0.01

Table 4: Exogenous CEO Turnover, Changes in Managerial Ability, and Stock Market Reactions to Monetary Policy Surprises

This table reports six models examining how exogenous changes in managerial ability following CEO turnover affect firms' stock market reactions to monetary policy surprises. The sample is restricted to the second full year after CEO turnovers resulting from the CEO's passing. The key independent variable is the change in managerial ability, measured as the difference between the incoming CEO's managerial ability score in the first full year of the CEO's tenure and the deceased CEO's managerial ability score in the final full year of their tenure, scaled by its standard deviation in the sample. The dependent variable is the cumulative abnormal return (CAR), measured over alternative event windows: the two-day window covering the day of the announcement and the day that follows in Models (1)–(3), and the three-day window covering the announcement day and the following two trading days in Models (4)–(6). All specifications include a comprehensive set of fixed effects and control variables. Standard errors are clustered at the firm level, and clustering at the industry level yields similar results. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

Model	(1)	(2)	(3)	(4)	(5)	(6)
Independent\Dependent	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+1)$	$CAR(0,+2)$	$CAR(0,+2)$	$CAR(0,+2)$
$Contractionary\ Surprise$	-0.886***	-1.962***	-0.894***	-1.156***	-1.174***	-1.167***
	(0.205)	(0.305)	(0.208)	(0.261)	(0.264)	(0.262)
$Contractionary\ Surprise \times \Delta Managerial\ Ability$	0.626**	0.977***	0.654**	0.837**	0.902**	0.856**
	(0.284)	(0.351)	(0.297)	(0.360)	(0.376)	(0.367)
$Expansionary\ Surprise$	0.457**	0.417*	0.435**	0.397	0.353	0.393
	(0.214)	(0.215)	(0.219)	(0.272)	(0.278)	(0.298)
$Expansionary\ Surprise \times \Delta Managerial\ Ability$	0.711***	0.725***	0.768***	0.752**	0.713**	0.743**
	(0.247)	(0.279)	(0.280)	(0.313)	(0.355)	(0.354)
Control Factors	YES	YES	YES	YES	YES	YES
Firm Effects	NO	YES	NO	NO	YES	NO
Sector Effects	NO	NO	YES	NO	NO	YES
Year Effects	YES	YES	YES	YES	YES	YES
N	656	656	656	656	656	656
R^2	0.01	0.01	0.01	0.01	0.01	0.01

Table 5: Descriptive statistics for quarterly observations

This table presents the key descriptive statistics of the variables used in our panel regression analysis at the quarterly frequency. For each variable, we report the number of available observations, the mean, 25th percentile, median, 75th percentile, and standard deviation. The variables preceded by "Q_" represent the latest available observation for the key control variables in the quarter prior to the monetary shock.

Variable	N	Mean	25th Percentile	Median	75th Percentile	SD
Expansionary Shock	72847	0.67	0.00	0.13	0.95	1.00
Contractionary Shock	72847	0.62	0.00	0.00	1.06	1.00
Structural Efficiency	72847	0.30	0.23	0.30	0.37	0.15
Managerial Ability	72847	0.00	-0.07	-0.02	0.04	0.13
Q_Investment Rate	72847	1.50	0.53	0.98	1.83	1.84
Q_Assets	72847	4591	38.85	248.81	1536.70	22931
Q_RoA	72847	1.29	0.00	1.49	3.74	5.71
Q_Debt	72847	60.53	34.78	55.14	69.26	40.87
Q_Intangibles Percentage	72847	3.71	0.71	1.94	4.41	4.31
Q_No Dividends	72847	0.50	0.00	0.00	1.00	0.50
Q_Board Independence	72847	0.29	0.00	0.00	1.00	0.45
Q_Debt Constraint	72847	0.14	-0.27	0.14	0.45	0.57
Q_Unemployment	72847	5.63	4.41	5.71	6.00	1.59
Q_CPI	72847	200.91	171.13	211.18	239.87	35.77

Figure 1: Monetary surprises around FOMC announcements

This figure presents the changes in the three-month-ahead U.S. treasuries around Federal Open Market Committee (FOMC) meetings from January 1994 to December 2022. The data are obtained from Jarociński and Karadi (2020).

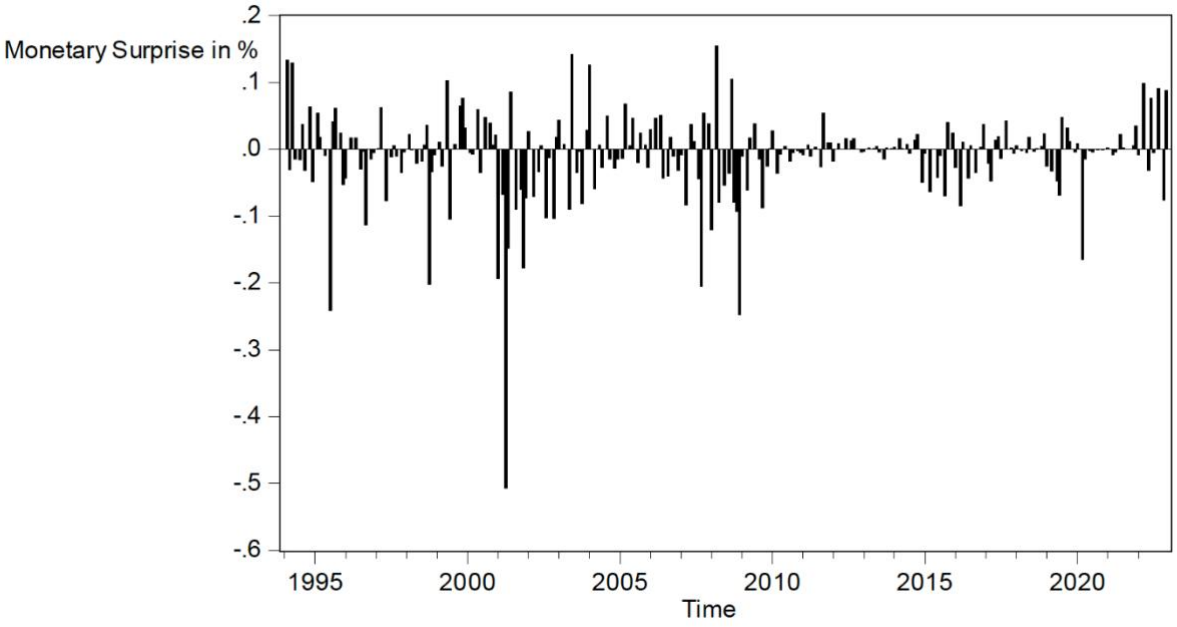


Figure 2: The evaluation of managerial ability's effects around exogenous CEO turnover

This figure illustrates the construction of the managerial ability change measure following exogenous turnover resulting from the CEO's passing. The deceased CEO's managerial ability is measured in the final full year of the tenure, while the incoming CEO's managerial ability is measured in the first full year following appointment. The change in managerial ability is defined as the difference between these two measures. To ensure that the incoming CEO has had sufficient time to influence the firm's strategic direction and operating decisions, the analysis is restricted to Federal Open Market Committee (FOMC) meetings occurring during the second full year following the CEO's appointment.

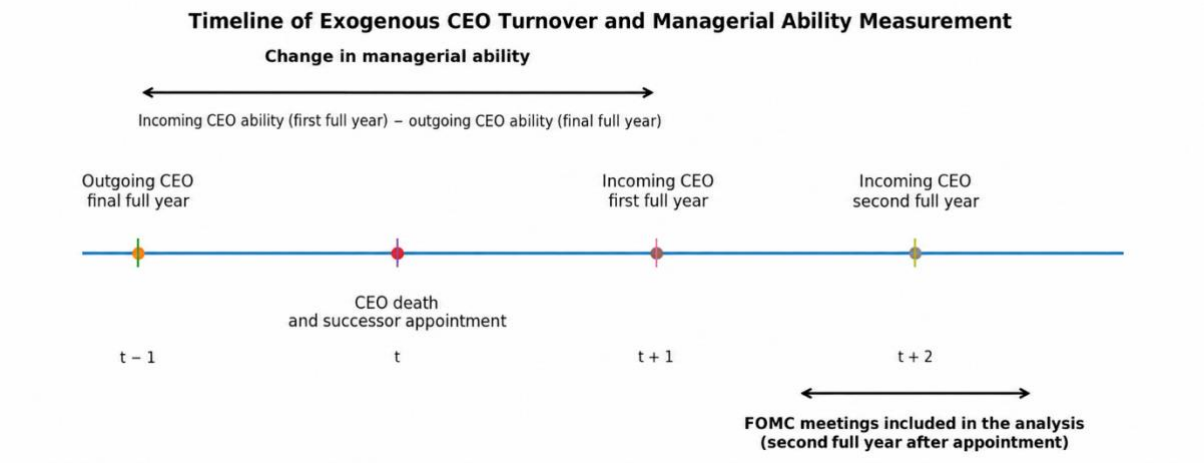


Figure 3: Quarterly monetary shocks

This figure presents the quarterly aggregated levels of the Bu et al. (2021) (BRW) monetary shocks from January 1994 to December 2020.

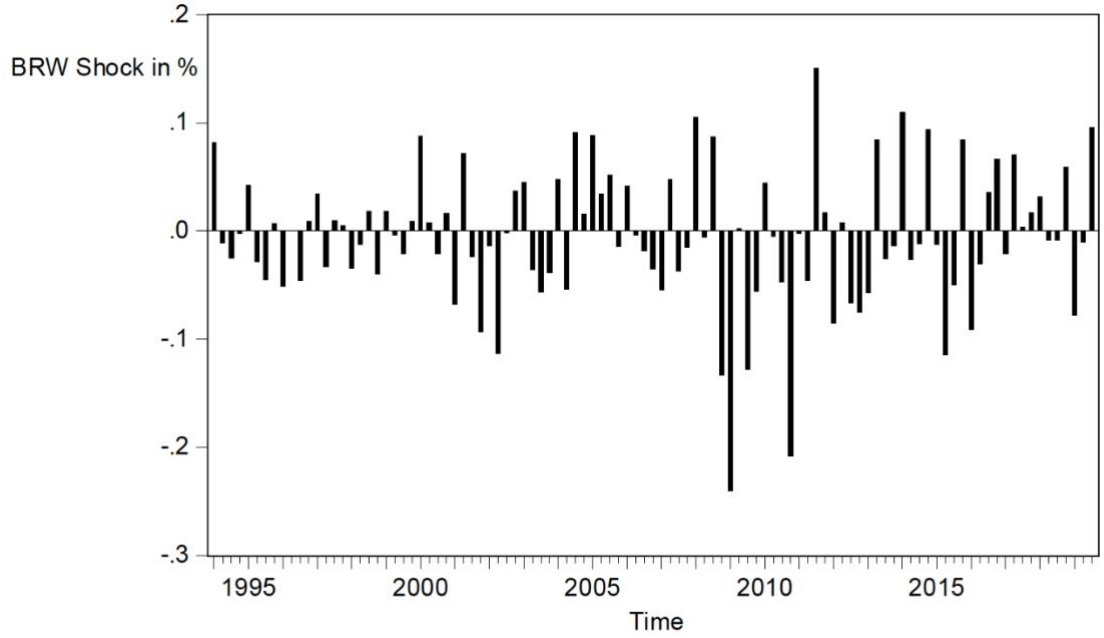


Figure 4: Dynamic response of firm growth to monetary policy shocks by managerial ability

This figure presents the impulse responses of firm growth to contractionary and expansionary monetary policy shocks, estimated using Equation (3). High-managerial-ability firms are those in the top quartile of the managerial ability distribution, while low-managerial-ability firms are those in the bottom quartile. The figure reports the estimated response of asset growth over the 12 quarters following a unit monetary policy shock. The left panel presents responses to contractionary shocks, while the right panel presents responses to expansionary shocks. Standard errors are clustered at the firm level, and the shaded areas represent 95% confidence intervals.

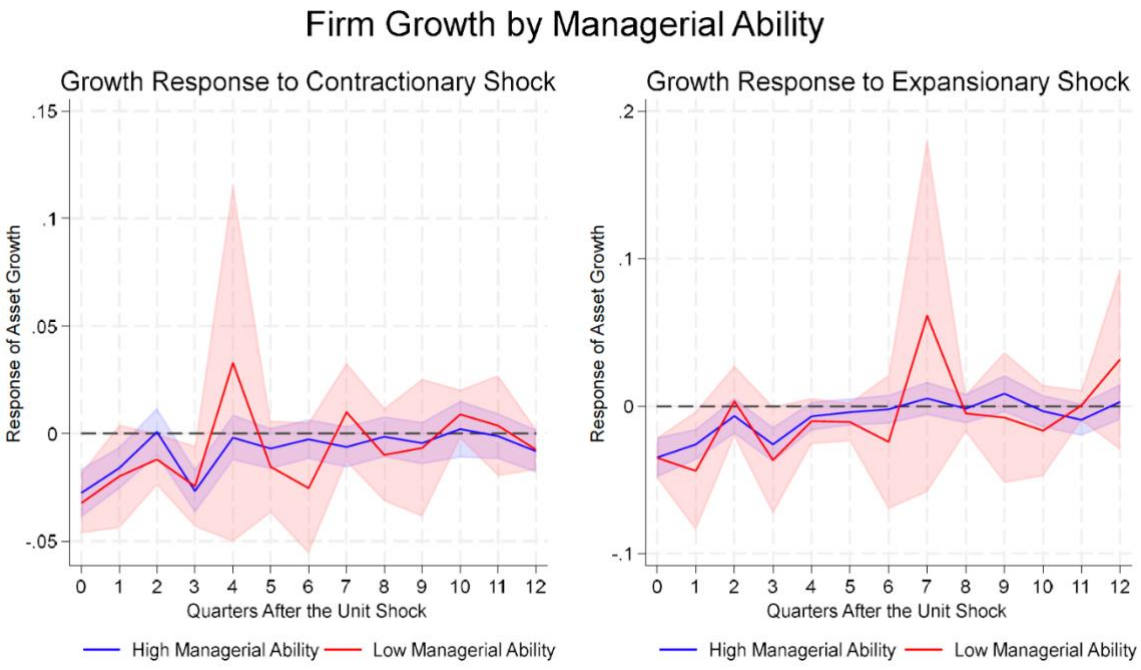


Figure 5: Dynamic response of leverage to monetary policy shocks by managerial ability

This figure presents the impulse responses of leverage to contractionary and expansionary monetary policy shocks, estimated using Equation (4). High-managerial-ability firms are those in the top quartile of the managerial ability distribution, while low-managerial-ability firms are those in the bottom quartile. The figure reports the estimated response of leverage over the 12 quarters following a unit monetary policy shock. The left panel presents responses to contractionary shocks, while the right panel presents responses to expansionary shocks. Standard errors are clustered at the firm level, and the shaded areas represent 95% confidence intervals.

