TURNOVER AND SUCCESSION OF SENIOR MANAGERS IN RUSSIAN PRIVATISED FIRMS

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EXTENDED ABSTRACT

A crucial element in the process of transition of the Russian economy from plan to market was privatisation of state-owned enterprises, undertaken with the ultimate goal of improving their efficiency. The degree to which this goal is achieved under private ownership and corporate governance depends on two factors: reallocation of managers to achieve better matching between managerial talent and enterprise assets and establishment of appropriate incentives for managers.

At the start of transition it was apparent that the skills-mix of existing managers was inappropriate for the emerging market environment, therefore a bulk of the managers had to be replaced. However, this problem could not be solved quickly due to limited supply of competent managers. Yet there was a huge potential for efficiency improvements through reallocation of the existing managers since it was hardly the case in the early 1990s that larger and more complex organizations were run by more talented managers. The reason is that in the era of socialism managers of state enterprises were promoted for the adherence to the communist ideology or had the jobs because they were proficient in lobbying the government for credits and securing delivery of inputs, not for their ability. In other words, turnover of managers was necessary to improve matching between managers and productive assets.

The incentive issue in Russia was of particular importance given the scope of opportunism of managers. In fact, in the last years of the planning era they gradually assumed many of the rights attached to private property ownership and had almost unrestricted control over enterprise assets. Privatisation was a means to re-establish control over managers and provide them with right incentives, however, this was not easily achieved with existing managers. In particular, various monetary incentive schemes provided by shareholders were hardly sufficient to solve the problem of managerial opportunism since the owners could offer only a part of company profits as incentive, which was often less than what the managers could appropriate themselves. In such cases the most powerful incentive (and perhaps the only one in the Russian context) for managers was the threat of dismissal if they performed poorly. Thus, replacement of managers was a crucial mechanism of providing them with incentives.

There has been little research on management turnover in Russia despite the importance of this process. Abundant anecdotal evidence rather tells us that management turnover may not serve the goals of better matching and better incentives for the simple reason that replacement of managers may have nothing to do with their performance. This paper aims to investigate the issue more systematically by focusing on two issues: determinants of CEO replacement in Russian privatised firms and determinants of the choice between inside and outside successors. Privatised enterprises are selected due to their dominating role in the Russian economy and separation of ownership and control which is inherent to them and which exacerbates the role of managerial turnover.

In public companies, turnover of CEOs may occur for several reasons including retirement due to age, which is often mandatory, health problems, death, voluntary resignations, and forced resignations which are of main interest in this paper. The theoretical literature says that decisions involving forced resignations of CEO are affected by their performance and the ability of monitors to accurately assess it, ownership (in particular, CEO stock ownership),

board composition, availability of a capable successor (which depends on a number of factors, including how well the market for managers functions), etc.

After CEO departure, a firm faces with the choice between inside and outside appointments which entail different costs and lead to different consequences for firm performance. In most cases this choice is usually determined by characteristics of the firm and the industries in which it operates. More precisely, the factors are often similar to those affecting CEO turnover and include prior performance of firms, the level of firm-specific human capital, firm size, degree of industry homogeneity, etc.

Empirical analysis is based on a sample of 419 medium-sized and large privatised companies of manufacturing industries surveyed by the Bureau of Economic Analysis. Using probit regressions, the paper investigates how turnover of CEOs between January in 1999 and May 2000 is related to prior performance of firms (in 1998), their ownership, size and industry affiliation. It must be noted that turnover is defined broadly to include both routine and non-routine cases. Using a sub-sample of the firms that changed their CEOs in 1999-2000, the paper also focuses on determinants of inside and outside successions. Firm performance is measured as labour productivity (industry-adjusted) and profitability (ROE), ownership is represented by shares of outside owners in company equity (inside ownership by managers and workers is used as a base category).

Empirical analysis yields the following main results: the probability of CEO turnover is negatively related to prior performance of firms measured by labour productivity, implying that replacement is more likely to occur in poorly performing companies. For profitability the relationship is also inversed, but only marginally significant. This result does not contradict the hypotheses that managerial turnover in Russian companies leads to better matching and better incentives of managers. More generally, this finding runs contrary to the widely held beliefs that corporate governance is non-existent in Russia. Analysis also indicates that outside ownership is associated with higher turnover rates while inside ownership prevents CEO changes. The state seems to play an important role in CEO turnover, the coefficients on state ownership variables are higher and statistically different from coefficients on several other categories of outside ownership.

Surprisingly, CEO succession is unrelated to labour productivity, but is positively correlated with profitability: the higher the prior ROE, the greater the probability of outside succession. This result may be interpreted the following way: obtaining top positions in companies with poor profitability is not an attractive option for outsiders. These firms may be unable to offer a decent compensation for outside managers and are therefore unable to hire them. This may lead to a vicious circle: revitalization of poorly performing firms requires competent outside managers, but the firms are unable to hire them and, as a result, they change managers for poor performance more frequently. Ownership effects deserve special attention: there is a clear differentiation between various groups of outside owners. The state on the federal level as well as foreigners tend to appoint insiders while the state on the regional level as well as firms tend to appoint outsiders. This difference may stem from unequal access of these groups to local managerial labour markets. Finally, the impact of firm size on succession is the opposite to what the theory predicts as there is a tendency to appoint outside managers in larger firms.