



# **Does corporate performance matter for the changes in the Boards and the dismissal of CEO? Strategic oversight of boards in emerging capital market of Russia**

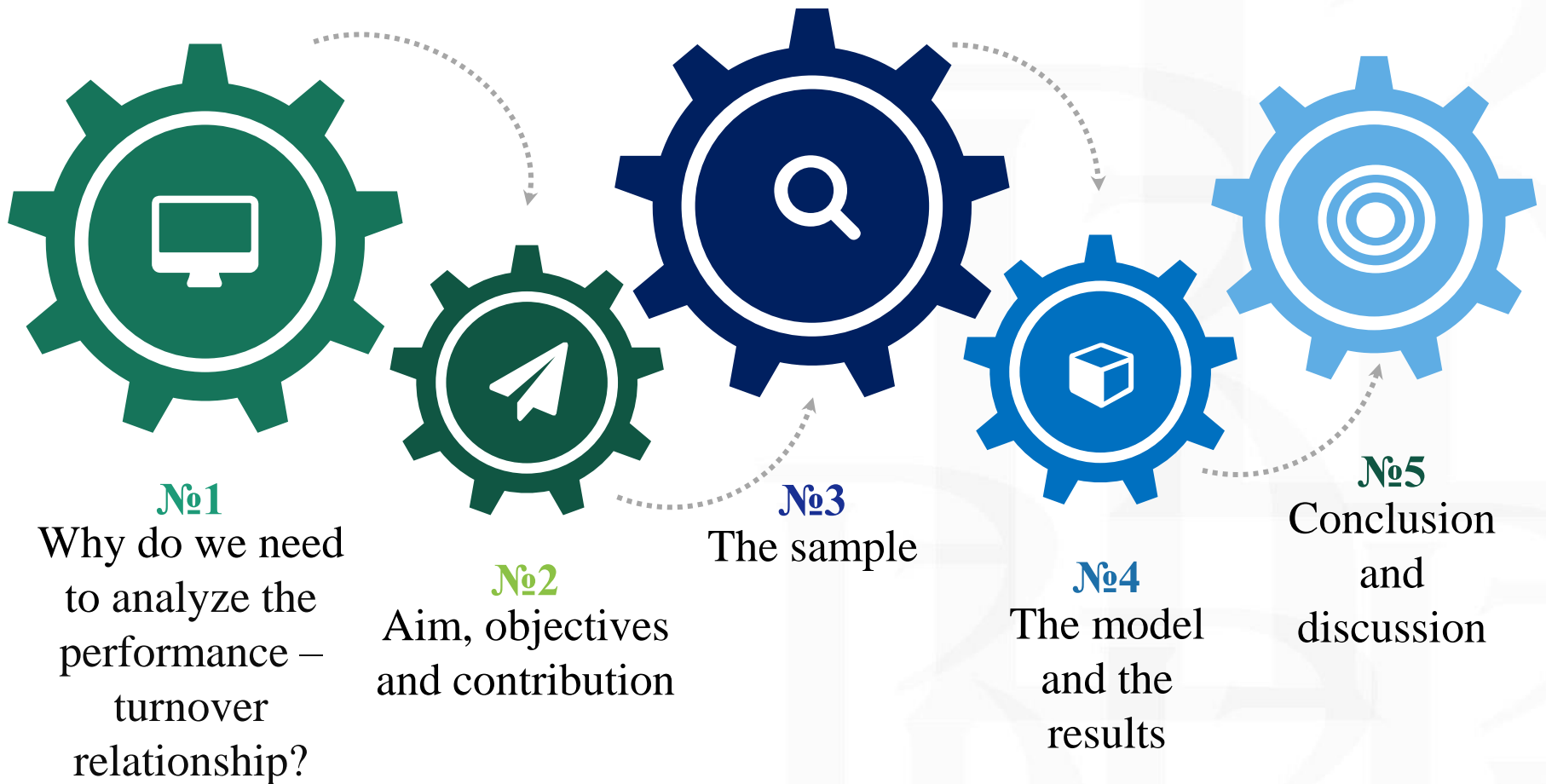
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# Agenda



# Agency Perspective

The agent is motivated to act in his own best interests rather than those of the principal.

## Board's strategic oversight:

- Focused on balancing conflicts of interests and compromises
- Focused on strategic vision and strategy
- monitoring role

effectiveness of directors can be estimated due to the company performance.



## Accounting based measures



## Market based measures



## Economic profit conception

*ROA, ROE, EBIT, R&D, Capex*

*Stock returns, Tobin Q*

*Residual Income*

# Human capital perspective

	<b>General human capital</b>	<b>Firm-specific human capital</b>
<b>Definition</b>	CEOs ability that is valued by all employers. general capital is more important than firm-specific.	work experience, knowledge and skills of CEO that can be valued only in one particular company due to their characteristics
<b>Measures</b>	MBA degree, education, CEO age	CEO tenure
<b>Authors</b>	Aivazian, Lai and Rahaman (2010), Hutchinson and Russell (2013), Frydman (2007) and Bertrand (2009)	Crook et al (2011), Hutchinson and Russell (2013)

# CEO turnover – Performance relationship

<b>Results</b>	<b>The probability of CEO dismissal is MORE sensitive in case of accounting based measure than for market-based approach.</b>	
<b>Confirmed by</b>	<b>Developed</b>	<b>Emerging</b>
<b>Authors</b>	Engle, Hayes, Wang (2003); HomRoy S. (2015); Weisbach (1988); Warner, Watts, Wruck (1988); HomRoy S. (2015)	Gibson S. M. (2003); Rachpradit and Khang (2012); M.J. Conyon and L. He (2014)
<b>Results</b>	<b>Inverse relationship between stock-price performance and the probability of CEO turnover.</b>	
<b>Confirmed by</b>	<b>Developed</b>	<b>Emerging</b>
<b>Authors</b>	Coughlan and Schmidt (1985); Benston (1985); Kaplan (1997); Suchard, Singh and Barr (2001); M. F. Wiersema and Y. Zhang (2011)	Kato T. and Long C.(2006)
<b>Results</b>	<b>The probability of CEO turnover is MORE sensitive to earnings changes and stock returns Capex, advertising expenses (after adjusted for industry ) are significantly and negatively related to CEO turnover.</b>	
	<b>Murphy and Zimmerrmun, (1993)</b>	

# Financial architecture and performance-turnover relationship

<b>Independent directors</b>	If large proportion of outside directors in Board of Directors, the probability of CEO dismissal increases in of poor performance.	
<b>Confirmed by</b>	<b>Developed</b>	<b>Emerging</b>
<b>Authors</b>	Weisbach (1988); Conyon (1998); Laux (2005); Kaplan and Minton (2012); Mobbs (2013); Dah, Frye, Hurst (2014); HomRoy (2015); Hillier D. and McColgan P. (2009)	Kato and Long (2006); Rachpradit and Khang (2012)
<b>CEO ownership</b>	IF CEOs ownership is high, the probability of CEO turnover significantly decreases	
<b>Confirmed by</b>	<b>Developed</b>	<b>Emerging</b>
<b>Authors</b>	Denis, Denis, and Sarin (1997); Gao, Harford, Li (2014) , HomRoy S. (2015) Brunello, Graziano and Parigi (2003)	Gibson (2003), Conyon, He (2014)
<b>CEO duality</b>	If CEO is Chairman , the probability of CEO turnover due to poor performance decreases (HomRoy (2015), Lausten (2002)	
<b>Ownership concentration</b>	If case of large shareholder (more than 50% of shares), the performance-turnover relationship are stronger than in companies with less than 50%. (Chi and Wang (2009))	

# Board changes

Results	Authors
<p><b>Inverse relationship between income changes and the likelihood of board turnover</b></p>	<p>Mulcahy (2014) Srinivasan (2005) ; Gilson (1990); Easterwood, Ince and Raheja (2012)</p>
<p><b>Inverse relationship between market-based firm performance and board changes.</b></p>	<p>Liu, Wang, Zhao and Ahlstrom (2013); Denis and Sarin (1999)</p>
<p><b>If company has poor performance, it tends to replace inside directors in the board for outsiders</b></p>	<p>Hermalin, Weisbach (1988); Renneboog (2000)</p>
<p><b>Two types of performance measures show significant negative influence on boards' turnover for BOTH inside and outside directors.</b> <b>Author also couldn't specify the role of non-executive directors.</b></p>	<p>Gisper (1998)</p>

# Emerging Markets Framework



## Agency conflicts :

Agent-principal

Majority shareholders – minority shareholders



## Financial architecture:

-high concentration of ownership motivates for stronger performance monitoring by large shareholder

- state ownership motivates for different means of regulating managerial behavior and may compensate for the lack of strong performance – turnover relationship

## Board's strategic oversight:

- Focused on balancing conflicts of interests and findings compromises
- Performance monitoring
- Board's effectiveness related to performance



# Aims and Contribution

*The determinants of performance - CEO turnover and performance - changes in the Board of directors in the large emerging market of Russia*

- **Despite the differences in the level of CG development, the strategic oversight of Board via CEO dismissal due to bad performance holds**
- **Different patterns** of CEO turnover-performance relationship:
  - “ Oligarch” firms
  - State market based
- Human capital of CEO (education&experience) is significant
- Determinants of performance- Chairman change differ from CEO turnover -performance



# Hypotheses

## Main group of hypotheses for CEO:

H1.1 Firm performance has a negative influence on CEO turnover.

H1.2 Accounting - based measure of performance has stronger influence on CEO turnover than market based performance.

## Financial architecture – CEO dismissal:

H2.1 When firm performance is poor, the probability of CEO dismissal is higher if company is controlled by private major shareholder (“an oligarch”).

H2.2 When firm performance is poor, the probability of CEO dismissal is lower if state is a large owner.

## CEO characteristics- CEO turnover

H3.1 CEO age has an influence on the performance-CEO turnover relations.

H3.2 The type of CEO’s education has an impact on performance-CEO turnover

## Board Changes

H4. Board changes have negative relations with firm performance



$$\begin{aligned}
 \text{CEO turnover} = & a + \beta_1 \text{Market cap}_{i,t} + \beta_2 \text{ROA}_{i,t-1} + \\
 & \beta_3 \text{ROE}_{i,t-1} + \beta_4 \ln \text{CEO age}_{i,t} + \varepsilon_i
 \end{aligned}$$

CEO turnover is tested with logit model:  $\ln \left[ \frac{p}{1-p} \right]$ , where  $p$  is a probability of CEO dismissal and as dependent variable we use the logarithm  $\ln \left[ \frac{p}{1-p} \right]$  of the odds ratio of CEO removal.

$$\begin{aligned}
 \text{Chairman changes} = & a + \beta_1 \text{Market cap}_{i,t} + \beta_2 \text{ROA}_{i,t-1} + \\
 & \beta_3 \ln \text{BDsize}_{i,t} + \beta_4 \ln \text{BDmeet}_{i,t} + \varepsilon_i
 \end{aligned}$$

Chairman changes are tested with logit model: Where  $p$  is a probability of Chairman changes and as dependent variable we use the logarithm  $\ln \left[ \frac{p}{1-p} \right]$  of the odds ratio of CEO removal.

# Variables

<b>Variables</b>	<b>Name</b>	<b>Definition</b>
<b>ROA t-1</b>	roa_iat1	Net Income divided by total Assets, adjusted for industry
<b>ROE t-1</b>	roe_iat1	Net Income divided by Equity, adjusted for industry
<b>Market cap<sub>t</sub></b>	Hmc_ta	Total firm's market value divided by total assets
<b>CEO_turn</b>	CEO	Dummy variable equals 1 in case of CEO turnover
<b>CEO oligarch</b>	CEOolig	Dummy variable equals 1 in case of CEO turnover and if oligarch is a major shareholder
<b>State</b>	CEOstate	Dummy variable equals 1 in case of CEO turnover and when state is a shareholder
<b>Board size</b>	LnBDsize	Log of number of directors in board
<b>CEO age</b>	Inceoage	Log of CEO age
<b>Chairman Turnover</b>	Chairman	Dummy variable equals 1 in case of Chairman turnover
<b>CEO characteristics</b>	CEOmba, CEOed, CEOsci	Dummy variable equals 1, if CEO has MBA; has technical education; If CEO has a science degree

	Freq		Percent		Total	
	0	1	0	1	Freq	%
<b>Changes (1=yes)</b>						
<b>Chairman</b>	359	132	73,12%	<b>26,88%</b>	<b>491</b>	100%
<b>CEO</b>	465	129	78,28%	<b>21,72%</b>	<b>594</b>	100%

Variable	Obs	Mean	Min	Max
<b>CEO age</b>	576	48,6	28	70
<b>Board size</b>	564	9,49	5	17

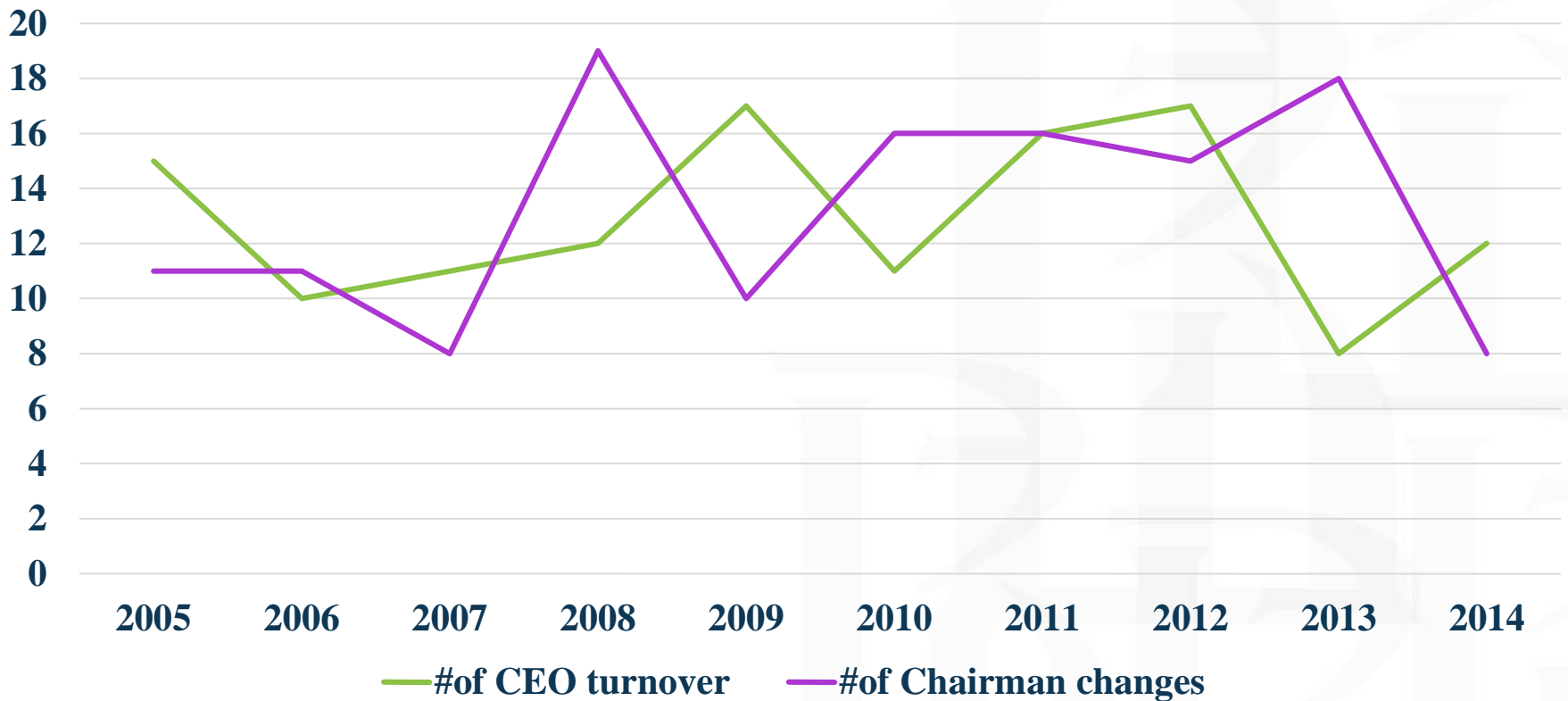
**65 Russian public companies**



**10 years period:  
2005-2014**

# CEO and Chairman turnover pattern

## CEO and Chairman turnover pattern



# Human Capital statistics

Total sample	Freq		Percent		Total	
	0	1	0	1	Freq	Percent
CEO education 1-(technical ed; 0-other)	198	367	35,04%	<b>64,94%</b>	565	100%
CEO MBA (1-yes)	523	55	90,48%	<b>9,52%</b>	578	100%
CEO science degree	398	184	68,38%	<b>31,62%</b>	582	100%

Companies with state participant in ownership	Freq		Percent		Total	
	0	1	0	1	Freq	Percent
CEO education	77	158	<b>32,77%</b>	<b>67,23%</b>	235	100%
CEO MBA	209	23	<b>90,09%</b>	<b>9,91%</b>	232	100%
CEO science degree	146	90	<b>61,86%</b>	<b>38,14%</b>	236	100%

Companies with large internal shareholder ("an oligarch)	Freq		Percent		Total	
	0	1	0	1	Freq	Percent
CEO education	78	149	<b>34,36%</b>	<b>65,64%</b>	227	100%
CEO MBA	218	19	<b>91,98%</b>	<b>8,02%</b>	237	100%
CEO science degree	162	75	<b>68,35%</b>	<b>31,65%</b>	237	100%

# Results. CEO turnover

Variables	CEO total sample		CEO +oligarch		CEO+ state	
	Coefficient	Marginal effects	Coefficient	Marginal effects	Coefficient	Marginal effects
Hmc_ta	<b>-.583 **</b>	<b>-.583 **</b>	.170	.004	-1.448***	<b>-.075***</b>
roa_iat1	-2.613	-2.613	-7.198 **	<b>-.184***</b>	3.278	.170
roe_iat1	.377	.377	1.118	.0286	.134	.007
Inceoage	<b>-3.692*</b>	-3.692*	-3.126***	-.080	-.966	-.050

**H1**      **H3.1**      **H2.2**

\* - significance at 1% level; \*\* - significance at 5% level; \*\*\* - significance at 10% level



# Results. CEO turnover

## Main group of hypotheses for CEO:

H1.1 Firm performance has a negative influence on CEO turnover

H1.2 Accounting - based measure of performance has stronger influence on CEO turnover than market based performance.

## Group of financial architecture for CEO turnover:

H2.1 When firm performance is poor, the probability of CEO dismissal is higher if company is controlled by private major shareholder (“an oligarch”).

H2.2 When firm performance is poor, the probability of CEO dismissal is lower if state is a large owner.

### Confirmed



Agree with previous researches (Murphy and Zimmrrmun (1993), Weisbach (1988) etc)



For total sample: contradicts to previous researches (Weisbach (1988), Engle et (2003), HomRoy S. (2015)). Confirms Barro and Barro (1990).

For subsample where oligarch is a shareholder the hypothesis is confirmed.



Contradicts to previous researches (Conyon and He (2014), Chi and Wang (2009))



Confirms previous researches (Kato and Long (2006))

# Results. CEO turnover

Variables	Total Sample	Oligarch	State
<b>MBA</b>			
Hmc_ta	-0.38601***	0.198394	-1.39666**
roa_iat1	-2.05744	-7.32022**	3.478
roe_iat1	0.423397	1.119341	0.088371
Inceoage	-1.93326**	-3.04969***	-0.82996
CEOmba	-0.13298	0.547651	0.768008
<b>Technical or economic education</b>			
Hmc_ta	-0.28789	0.178753	-1.45386*
roa_iat1	-2.88922	-8.21001**	3.258281
roe_iat1	0.403458	1.073612	0.050408
Inceoage	-2.08848**	-2.39735	-2.12716
CEOed	0.206204	-0.51142	<b>1.055503**</b>

Variables	Total Sample	Oligarch	State
<b>Science degree</b>			
Hmc_ta	-0.40700***	0.16715	-1.44167*
roa_iat1	-2.20615	-7.21214**	3.285773
roe_iat1	0.414616	1.117566	0.13753
Inceoage	-1.99963**	-3.08885***	-0.95743
CEOsci	0.187713	0.127963	-0.05684

**H3.2**



# Results. CEO characteristics

## Group of CEO characteristics:

H3.1 CEO age has an influence on the performance-CEO turnover relations.

H3.2 CEO's education has an impact on performance-CEO turnover relations

### *Confirmed*



This result matches with the results Conyon (1998) and Jensen and Murphy (1990).

We confirmed this hypothesis for the subsample of state-affiliated companies\*

\* This can be explained by the specific feature of USSR educational system, when the alumni of the universities were distributed by the state to the exact companies in different regions depending on their specialization and on the labor demand.

# Results. Chairman changes

Chairman	Coef.	Std. Err	z	P> z	[95% Conf. Interval]	
<b>hmc_ta</b>	-0.15585	0.266665	-0.58	<b>0.559</b>	-0.67851	0.366801
<b>roa_iat1</b>	-0.92703	2.023103	-0.46	<b>0.647</b>	-4.89224	3.038183
<b>lnBDsize</b>	0.553181	0.991806	0.56	0.577	-1.39072	2.497085
<b>lnBDmeet</b>	1.040213	0.376692	2.76	0.006	0.301911	1.778515

## Board Changes

H4. Board changes have negative relations with firm performance

**The last hypothesis (H4) is rejected. The results contradicts to Liu, Wang, Zhao and Ahlstrom (2013)**

# Conclusion

## CEO turnover in Russia

Using Russian market we supported that CEO can be dismissed if company has poor performance. That support previous researches on emerging and developed markets.



## The specificity of Russian companies

The feature of Russian market is ownership structure: mainly public companies are divided by two main groups: state ownership and oligarch.



## The influence of ownership structure

Different shareholders estimate CEO with different measures of performance.



## CEO age

More younger CEO has more chances to be dismissed if company has bad performance. This results is the same as in researches in developed markets.



## CEO education

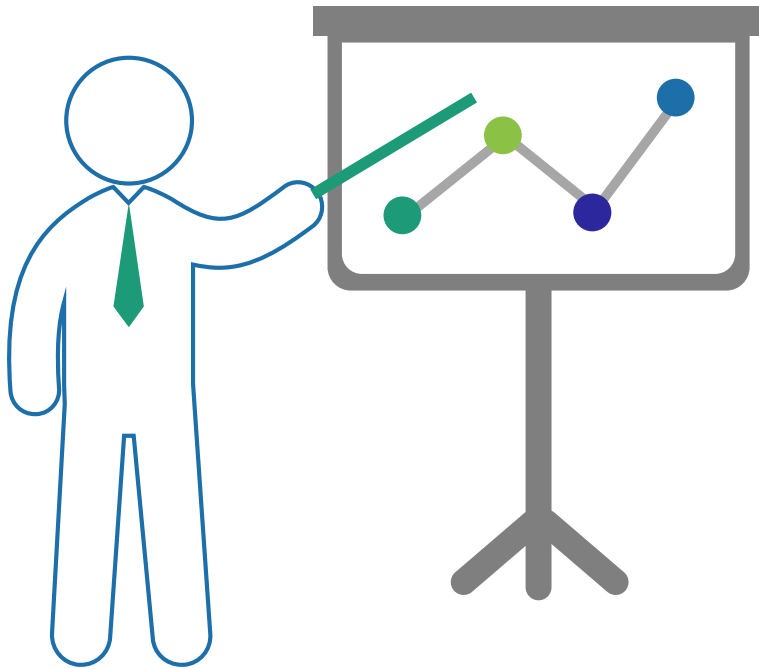
Mainly in Russia CEO is working with their specialization that they receive in the university. This is the specific feature that comes from USSR educational system.



## Chairman changes

In Russian the decline in performance is not the reason of Chairman changes.





## RESEARCH PERSPECTIVES:

- To investigate how performance measures influence on board changes and in what cases this relationship works.
- To investigate how board composition influence on performance-turnover relations
- What more factors of CEO and Board characteristics can influence



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# Thank you for your attention!

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