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TURNOVER AMONG TOP CEOs: HESITATION WALTZ OR LUCRATIVE ROUND

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Over the last fifteen years, there has been an acceleration in the turnover of top CEOs in the 250 largest companies listed on EURONEXT, and even among the 2500 biggest global firms. But is this a hesitation waltz provoked by the fear of poor performance over the medium term, or is it more of a lucrative round dance enabling CEOs to make more money by moving from one firm to another? The synthesis we propose here[1] takes stock of a phenomenon of considerable importance to modern finance capitalism. We will start by defining what we mean by "hesitation waltz", and then study the symmetrical concept of "profitable round dance". Here, finance capitalism is compared to a frantic dance whose tempo is accelerating.

The hesitation waltz before the crisis

More than a passing phenomenon of hesitant behaviour, we use the term hesitation waltz to describe the changing of CEOs provoked by panic in the face of catastrophic results or improvements that are too slow for shareholders impatient to reap large dividends. We have brought to light the problem of the efficiency of the corporate governance system in France, confirming empirically that *the probability of management turnover is negatively related to the performance of the firm.*

Thus, a decline in the performance index triggers certain control mechanisms that ensure the rapid removal of any CEO who fails to come up to the mark. The dismissal often follows a "hesitation waltz" during which the boards of directors weigh up the pros and cons of taking such action. This phenomenon depends on the pressure of the capital markets, a continued fall in the share price and information that the majority shareholders have about the competition, in the form of benchmarking (i.e., "what is our main competitor doing?"). But management turnover in response to poor performance is just one of several criteria for judging the efficiency of the governance system, because the confirmation of this hypothesis cannot under any circumstances qualify the French governance system as being *totally efficient*. Over and above efficiency, which relates to the means used, there is efficacy, which concerns the results achieved, and effectiveness, which targets the average objectives of performance in the sector.

The hesitation waltz is due to the difficulty of evaluating these three criteria in a strategic plan. The firm can be efficient without being efficacious, efficacious without being effective and effective without being able to follow the leader of the sector, who is often ahead of the others for a very long time (as illustrated by the current transformation of the mobile phone sector, with Orange in the lead and the other operators restructuring). Financiers are too focused on efficiency, only slightly interested in efficacy and tend to ignore effectiveness altogether. Strategists are too quick to dismiss the psychological dimension of the cocooned world of top company directors. One must start again from the theory of Jean-Pierre Neveu[2] to go further.

In our empirical work we have introduced other control variables into the estimation model to draw a profile of the companies that tend to dismiss their managers more systematically. The statistical results show that of all the variables tested, the CEO's length of tenure is the only one to have a significant negative effect on the probability of turnover. Thus, the managers who have

[1] This brief is drawn from: L. Azzabi et L. Marco (2012) « La valse des dirigeants rend-elle la firme plus performante ? Étude exploratoire sur les sociétés cotées (2000-2009) », *Recherches en Sciences de Gestion*, I, n° 88, p. 131-149.

[2] J.-P. Neveu (1996) *La démission du cadre d'entreprise: étude sur l'intention de départ volontaire*, Paris, Economica.

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been in place for longest are more difficult to dismiss, because they have constructed a defensive network among the majority shareholders, or thanks to blocking minorities. Unless they are attracted by the prospect of making some quick money and lured away by headhunting firms commissioned by worried firms.

Our study analyses management turnover between the beginning of the internet boom and the subprime crisis, a fairly dynamic economic period that ended in financial panic. The hesitation waltz therefore depends on the psychological climate among stock market investors. If the underlying trend is upwards, the waltz is short-lived because there are many options available; when the crisis arrives, the options diminish, which increases the length of the hesitation waltz. Let us now see how CEOs have transformed the turnover imposed on them into a clever way to boost their income. During the hesitation waltz, the dancer invites the belle of the ball and leaves with the bride's bouquet and the regrets of his disappointed rivals. But everyone is quick to understand where their interests lie, and all the top CEOs join the round dance. The belle passes from hand to hand and everybody has a good time.

The lucrative round dance since the beginning of the crisis

The round dance is accompanied by a lively tune, and here the CEOs dance when profits have recovered and the capital markets are satisfied. We use the term lucrative round dance to describe the CEO turnovers which immediately generate hope of a significant improvement in financial results, in a difficult economic climate that obscures the strategic vision of the majority shareholders. But for whom is it lucrative? For the bosses who get fat or for the firms which get thinner?

This dark side[3] of the round dance has been studied by Olivier Weinstein:[4] "The disconnection between the pursuit of higher payments for top executives and the profitability of shares, observed in the 2000s and up until today [February 2010] during the crisis, raises the question of the exact nature of the existing system and the real position of the managers." It is therefore the ability of top CEOs to control recruitment to the board of directors of their company that explains this vicious circle pushing their incomes infinitely high. The principle of the "unlimited accumulation of wealth", as our master Adam Smith wrote before this dance had even been invented!

The recent study by Hazar Ben Barka confirms this idea for the particular case of independent directors.[5] She concludes that in the big French companies, holding multiple posts does not seem to be a sign of management entrenchment. This may be due to the fact that the presence of leadership within the board of directors can improve decision-making and the performance of the firm. In addition, as Brickley et al. (1997)[6] point out, for a CEO to hold multiple posts reduces agency costs. The board of directors only has one person to control instead of two (the chairman of the board and the CEO) if the two posts are separated, and there is greater asymmetry of information. Their proclaimed independence is illusory when they become the accomplices of the compensation committees who award the following advantages:

- golden hello: a signing bonus paid to new recruits,
- stock options: options to buy company shares, to win the loyalty of the new CEO,
- golden parachute: benefits that the CEO will receive if his employment is terminated, defined at the time of hiring and unrelated to performance,
- supplemental executive retirement plans (SERPs).

One example of a systematic round dance is the telecommunications giant Huawei, which has invented the fixed-term CEO! Every six months the CEO changes. The aim is to benefit from the dynamism of the newcomer in the face of fierce competition from Apple and Samsung. According to the financial experts, however, this system of super-fast management turnover has limitations: deterioration of the corporate image, prohibitive cost in terms of bonuses (incoming and outgoing), lack of consistency, aporia of the long-term view. The round dance exhausts its dancers when the music is too fast.

But the round dance which raced out of control during the crisis of 2008 subsequently slowed

[3] L. Bach and D. Metzger (2013) *The Dark Side of Shareholder Activism: Evidence form CEO Turnovers, Swedish House of Finance*, Research Paper, n° 13-01, 8 april, 43 p.

[4] O. WEINSTEIN (2010) *Pouvoir, finance et connaissance : les transformations de l'entreprise capitaliste entre XXe et XXIe siècle*, Paris, La Découverte, p. 105.

[5] H. Ben Barka (2013) *L'indépendance des administrateurs des sociétés cotées en France*, Saarbrücken, Presses Académiques Francophones. See also : W. Bouaine et *alii* (2014) "The Influence of CEO Departure Type and Board Characteristics on Firm Performance", *Working Papers Series*, IPAG Business School, 14 p.

[6] J. Brickley, , J. Coles, and G. Jarrell (1997) "Leadership Structure: Separating the CEO and the Chairman of the Board", *Journal of Corporate Finance*, 3, p. 189-220.

down, according to a study by Booz & Company.[7] In 2011, the average tenure of a CEO was 6.6 years, compared with 8 years in 2001. Less than 12% of the 2,500 biggest companies in the world changed their CEO in 2010, returning to the rate of 2003. There are two main reasons for this: a) a fall in the number of mergers and acquisitions, which account for half of management turnover; b) the rise of emerging countries, in particular China, where CEO tenure is more stable.

By hesitating between different CEO candidates with the same profiles, committees of recruitment simply accelerate the spiral of growing remunerations. A recent study on Malaysia confirmed this trend.[8] In 14 big Malaysian firms, the salary of CEOs represented on average 1.7% of the company's net profits, but departing managers received between 3.1 and 3.8% of these profits. So the round dance doubles the pay of those leaving. We propose four measures to limit this phenomenon:

- make public the contractual benefits accorded to CEOs on recruitment,[9]
- limit their compensation as a proportion of the firm's total wage bill,
- index-link their salary to the net profits of the firm,
- draw up contracts that cannot be terminated before six years have elapsed.

Conclusion

The hesitation waltz itself ends up being lucrative for the top CEOs who monopolise the most sought-after positions at the head of the flagships of financialized industry. We must wait until 2018 to obtain a series of ten financial years that will confirm or refute this analysis and allow us to compare the new results with those of the previous period. Every ten years the waltz accelerates and the round dance changes pace: performance shapes the tempo of the music and opens or closes the ball according to the energy of the dancers. It would therefore be useful to calculate more precisely the tempo of the music and the number of dancers.

7 http://www.booz.com/global/home/what-we-think/chief-executive-study

8 A. Tay and P.A.L. Bipinchandra (2013) "Compensating Human Capital in Organizations: The General Concerns about Paying Top Executives Excessively", *Scottish Journal of Arts, Social Sciences and Scientific Studies*, vol. 14, II, august, p. 158-174.

9 For example in the reports published by the financial journals (Les Echos, La Tribune, etc.).

Seminars & Conferences

4 - 7 june 2014 - Annual EURAM Conference (The European Academy of Management) – Valence
Track : *Business & Society*
Organized par Corinne Vercher (CEPN), Julienne Brabet (Université Paris-Est) and Rémi Jardat (ISTEC)
Thématics: *Institutions and Change ; Finance, Economy and Society : Towards sustainable re-embedding ; Leadership for Organisational Change and Resistance ; Crowdfunding : a path to social sustainability ? ; Social and Environmental Disclosure : Determinants and effects ; Responsible Management in Global Value Chains ; Psychoanalysis, Work, Organizations and Society.*

05 june 2014 – 12:45-14:00 – site of Villetaneuse University - Room K301
CEPN Seminar of Political Economy
FELIX BOGGIO (CEPN) : "*Temps logique et temps historique dans les théories du comportement en économie politique*"

6 juin 2014 – 14:00-17:00 – Site of Villetaneuse University
CEPN-DEFI-MIAP & IDHE Seminar
ERIC TYMOIGNE (LEWIS AND CLARK COLLEGE, PORTLAND & RESEARCH LEVY ECONOMICS INSTITUTE OF BARD COLLEGE) : *« The Rise and Fall of Money Manager Capitalism: A Minskian View of the Great Recession »*

11 june (09:30-16:30) et 12 june 2014 (09:30-13:00) – ISC (111 Rue Nationale, Paris 13e)
2d IFRIS-CEPN-Labex Sites Seminar: "DROITS DE PROPRIÉTÉ, COMMUNS ET ENTREPRISES"
Une relecture des théories de l'entreprise à partie de la notion de faisceau de droits
Coordination : par Benjamin Coriat (CEPN) & Fabienne Orsi (IRD et CEPN)

13 June 2014 – 09:30-16:30 – Site of MSH Paris-Nord – Room C
Workshop : "NOUVEAUX ENJEUX DE L'ASSURANCE SANTÉ COMPLÉMENTAIRE EN EUROPE"
Organized by CEPN-STRAS and the Health political Economy Seminar (SEPOSA)
Contacts : Nathalie Coutinet (nathalie .coutinet @univ-paris13.fr) Or Philippe Abecassis (philippe.abecassis@univ-paris13.fr)
Full program at USAhttp://ecoposante.free.fr

20 june 2014 – 14:00-17:00 – Site of Villetaneuse University
CEPN-DEFI-MIAP & IDHE Seminar
MATIAS VERNENGO (BUCKNELL UNIVERSITY, USA & CENTRAL BANK OF ARGENTINA) : *« Wage-led Growth and Center-Periphery Dynamics »*

27 june 2014 – 14:00-17:00 – Site of Villetaneuse University
CEPN-DEFI-MIAP & IDHE Seminar
GERALD EPSTEIN (PERI, UNIVERSITY OF MASSACHUSETTS, AMHERST, USA : *« Is it time to ditch the dollar? »*

2-4 July 2014 – ENS Cachan
Association Française d'Économie Politique - Conference : "ÉCONOMIE POLITIQUE ET DÉMOCRATIE"
Informations : http://afep2014.sciencesconf.org