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Executive turnover in China's state-owned enterprises: Government-oriented or market-oriented?

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ABSTRACT

Executive turnover is important in the governance of state-owned enterprises (SOEs). Herein, we focus on the executive turnover of China's SOEs, and the implementation of related evaluation mechanisms under different levels of government intervention. We collect executive turnover data of listed Chinese SOEs from 1999 to 2012, and find that about half of the SOE executives leave office within two terms, which is in line with government recommendations. Moreover, we find that more than a third of executives leave after less than one term, and nearly 20% after more than two terms, highlighting the uncertainty and unpredictability of executive appointments in SOEs. We also find that the executive evaluation mechanism for SOEs is implemented differently under different levels of government intervention. SOEs under weak intervention, such as those controlled indirectly by governments, controlled with low shareholdings, from non-regulated industries or in the Eastern regions, prefer the market-oriented evaluation method, which places more weight on executives' economic performance. In contrast, those under strong intervention prefer the government-oriented evaluation method, which is characterized by policy burden.

1. Introduction

In private enterprises with ownership and management separation, shareholders aiming for wealth maximization tend to design compensation incentive contracts and job-dismissing schemes that reward good

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managers and punish or fire the bad ones (Jensen and Meckling, 1976). In this single-task scenario, the principal designs incentive contracts that are compatible with the agent's goal to avoid conflict of interests (Alchian and Demsetz, 1972; Grossman and Hart, 1983). However, state-owned enterprises (SOEs) have multiple objectives, including economic, political and social goals, such as the value maintenance and appreciation of state-owned assets, maintaining social stability and conforming to macroeconomic regulations and controls (Lin and Li, 1997, 2004). However, these goals are often conflicting, which mean that the government needs to design reasonable incentive contracts to motivate SOE executives to focus their efforts on different goals. Focusing on different goals implies different outcomes and differing levels of corporate governance efficiency (Holmstrom and Milgrom, 1991).

Numerous studies have examined the relationship between manager turnover and performance among Chinese SOEs (Firth et al., 2006; Kato and Long, 2006a, 2006b; Chang and Wong, 2009; Song and Song, 2005; Jiang et al., 2014) based on the Western CEO turnover literature (Coughlan and Schmidt, 1985; Warner et al., 1988; Dedman, 2002; Defond and Hung, 2004; Neumann and Voetmann, 2005). However, few studies have examined the relationship between executive turnover and political performance among SOEs. Liao et al. (2009) use extra employment as a moderator variable to study its effect on the executive turnover-performance sensitivity of SOEs and examine the role that policy burden plays in the executive performance evaluation of SOEs. However, political performance is more than a moderator of evaluation. Bai and Tao (2006) take SOEs as multiple-task agents with political and economic goals, which is also emphasized by the "Measures for Comprehensive Evaluation of the Leadership in the Central Enterprises" (2009). Moreover, Lin and Li (1998, 2004) study the strategic and social policy burdens of SOEs, whereas Liao et al. (2009) only consider the social burden. We consider both of these factors in this paper. Lastly, the performance evaluation of SOE executives can be structurally different due to the different levels of government intervention, which are influenced by preferences of the government principals and the institutional environment. Therefore, it is necessary to test the executive turnover-performance relationship among SOEs in different settings.

This paper focuses on the executive turnover of China's SOEs and the implementation of the related evaluation mechanisms under different levels of government intervention. We examine data on Chinese state-owned listed firms' executive turnover from 1999 to 2012. First, we find that about half of the SOE executives leave office within two terms, in line with the "Interim Provisions on Business Performance Evaluations for Persons-in-Charge at Central Enterprises" (2003, 2006, 2009, 2012), more than a third leave after less than one term and nearly 20% leave after more than two terms, which highlights the uncertainty and unpredictability of executive appointments in SOEs. Second, the executive evaluation mechanism for SOEs is implemented differently under different levels of government intervention. SOEs under weak intervention, such as those controlled indirectly by the government, controlled with low shareholdings, from non-regulated industries or in the Eastern regions, prefer the market-oriented evaluation method, which places more weight on executives' economic performance than on political performance. In contrast, those under strong intervention prefer the government-oriented evaluation method, which is characterized by policy burden.

Our paper is the first to thoroughly describe the executive turnover of Chinese state-owned listed firms. We make several contributions to the literature. First, we provide basic data for studying the managerial market and corporate governance of SOEs in the Chinese capital market. Second, we empirically test the theoretically important question of how multi-task incentive contracts work under different levels of government intervention (Holmstrom and Milgrom, 1991). Finally, we show how SOE executives are evaluated and appointed, which helps us understand the relationship between SOE executive turnover and the managerial market, and shed light on the SOE marketization reform in China.

The remainder of this paper is organized as follows. Section 2 introduces the institutional background of SOE executive turnover in China, especially in relation to the changes in the SOE executive selection and evaluation mechanism. We also review the literature, present our theoretical analysis and develop our hypotheses in this section. In Section 3, we discuss the sample, variable measurement and research design. Section 4 presents the empirical results and robustness checks. Section 5 concludes the paper.