

## CONCENTRATED OWNERSHIP AND MANAGEMENT TURNOVER: THE CASE OF RUSSIA\*

**R. Kapelyushnikov, N. Demina**

### **Abstract**

The paper provides new survey evidence for effects of concentrated ownership on management turnover in Russian industrial firms. Our major findings are that managers' entrenchment is positively related to insider ownership and negatively, to the firms' performance. Therefore, probability of getting replaced is higher for poorly performing top executives than for those performing better.

### **1. Introduction**

Institutes of corporate governance are a major component of contemporary, highly sophisticated market economy. Their efficiency largely determines how well the managers' interests are balanced with the interests of the owners, how skillfully the attempts of opportunistic behavior are held back, how promptly the less competent teams of managers are replaced with the more competent ones, etc.

---

\* We thank participants in Workshop on Corporate Governance, Portoroz, Slovenia, November 2003, for their valuable comments.

This research was supported by a grant to the Institute for Southeast Europe, Slovenia; REB-Monitoring (Russian Economic Barometer), Russia; Center for East European Studies, Denmark, from USAID's SEGIR EP Contract No. 220/001.0-03-354, reference Russia task order no. 803, Improvement of Economic Policy Through Think Tank Partnership Project, administered by IRIS. The findings expressed herein are those of the authors, and do not necessarily reflect the views of the U.S. Agency for International Development.

Moscow Public Science Foundation sponsored this study at the expense of funds provided by United States Agency for International Development (USAID). The view expressed in this article may not coincide with viewpoints of the Agency for International Development (USAID) or Moscow Public Science Foundation.

### *Business Performance*

In transition economies, the need for building workable mechanisms of corporate governance is especially pressing, because "red directors" who took charge of enterprises under the old planned economy have no managerial knowledge and skills for working under the new, market conditions. This inevitably leads to large-scale rotation of top executives and to mass replacement of the majority of "old-style" directors with new, market-oriented managers.

In the Russian situation, this process was complicated by a specific privatization scheme, which had been implemented in the early stage of market reforms. It is well known that the Russian privatization program provided enormous advantages for insiders and resulted in accumulation of the bulk of equity in the hands of managers and workers. This insider-skewed profile was kept over the whole post-privatization period [1]. For instance, according to survey findings of the Russian Economic Barometer (REB), in 2003 insiders remained the largest group of shareholders with the combined stake close to 50% of total stock [2]. One might suggest that such a bias in the ownership profile should slow down the rotation of top executives and contribute to their "entrenchment".

Unfortunately, empirical studies of this range of problems are still very few. What was the actual speed of rotation of top managers at Russian enterprises during the period of transition? What factors determined this rotation? At which enterprises did these changes in the directors' corps go faster, and at which slower? How closely did these changes follow the shifts in the ownership structure? Did the probability of dismissal depend on the competence and efficiency of the top managers? What channels of their recruiting did prevail - the external or the internal ones? Who were the new directors in most cases - did they come from the same managerial teams as their predecessors, or were they Norman conquerors coming from the outside?

We attempt to answer some of these questions in this paper, using a series of surveys of privatized industrial companies conducted by the REB. The REB surveys provide a unique data-set on behavior and

expectations of Russian enterprises throughout the post-reform period. Since 1995, regular REB questionnaires have included on biannual basis a special block of questions on ownership structures and corporate governance of the respondent enterprises. The first of such surveys took place in 1995 (soon after the completion of the State Program of Mandatory Privatization), and the last was conducted in 2003, so that results for 1995, 1997, 1999, 2001 and 2003 are available. We rely on these data to identify major determinants of management turnover and management succession patterns, which have prevailed in the Russian industry.

The paper is organized as follows. In the next section, on basis of the REB survey findings, we make a descriptive analysis of management turnover in the Russian industry over the post-privatization period. Next, we provide some econometric evidence for determinants of management turnover and succession patterns at the REB respondent enterprises. Main conclusions are summarized in the final section.

## **2. Evolution of management turnover in the post-privatization period**

As we have already mentioned, what emerged in the Russian economy was insider-dominated ownership structure. However, it would be wrong to make a conclusion from this pattern that the old-time "red directors" were so strongly entrenched at their posts that they could happily survive all the troubles of transition. This suggestion is at odds with empirical data on tenure of CEOs and chairmen of the boards of directors at the REB respondent enterprises in 1995-2003 (see Tables 1 and 2.) As follows from these data, the majority of actual directors have come to run their businesses when the reforms were already under way, ascending to their posts after either dramatic changes in enterprise ownership structure or a battle between competing teams of managers, which had been formed under previous leadership.

*Business Performance*

**Table 1**  
**Distribution of REB Respondent Enterprises by Tenure of CEOs,**  
**1995-2003, %**

Groups of enterprises by term of tenure of CEOs	1995	1997	1998	1999	2000	2001	2002	2003
Less than one year	7.2	12.8	11.5	10.8	11.6	8.5	16.8	12.0
1-5 years	31.7	25.5	31.7	32.0	31.9	29.1	27.7	24.7
5-10 years	37.7	27.6	21.1	18.0	15.9	18.8	17.9	21.1
More than 10 years	23.4	34.2	35.7	39.2	40.6	43.6	37.6	42.2
Total	100	100	100	100	100	100	100	100
Average tenure, years	8.2	9.0	9.0	10.0	9.5	9.9	8.9	9.8

**Table 2**  
**Distribution of REB Respondent Enterprises by Tenure of**  
**Chairmen of the Boards of Directors, 2001 and 2003, %**

Groups of enterprises by term of tenure of chairmen of the boards of directors	2001	2003
Less than one year	20	21
1-5 years	55	50
5-10 years	25	29
Total	100	100
Average tenure, years	3,7	3,9

Although the turnover rate among the Russian top managers was lower in the post-reform period than could be expected considering the scale and sweeping nature of the changes, this rate stayed at a fairly high level. Every year, about 10% of the surveyed enterprises changed their CEOs, and 20% changed chairmen of their boards of directors. (Consequently, the former had a much slower speed of rotation than the latter). Average tenure of CEOs was in the range between 8-10 years, while average tenure of chairmen of board of directors was much shorter - less than 4 years. As a rule, a short length of a chairman's service came together with a short director's service, and vice versus. In other words, tenure of CEOs is fairly closely correlated with that of chairmen

of the board of directors (the correlation coefficient equals to 0.31 and is significant at the 1%-level of importance).

About 40% of the CEOs were appointed still in the Soviet times, and 60% were "new" directors who came to power after the start of market reform. At first sight, there is a contradiction: if the annual rate of rotation in the directors' corps, which was recorded in REB surveys, was as high as this, its complete replacement should be expected by 2003. This paradoxical combination of high turnover with substantial percentage of "old" directors inherited from the previous economic system implies that there exist two polar segments in the population of Russian industrial firms - the "unstable" one, where CEOs were replaced again and again in rather short intervals, and the "stable" one, where no renewal of CEOs had been made for a long time.

Tenure of top executives appears to be associated with characteristics of ownership structures and patterns of control. It is positively related to the stakes held by insiders and negatively related to the stakes held by outsiders. As the duration of the CEO's employment gets longer, the share of outside shareholders gets lower. On the contrary, the longer the present CEO is in charge of an enterprise, the more massive is the stake belonging to managers and workers. In 2003, at the enterprises where the tenure of the CEO was a less than one year, the proportion of outsiders to insiders in all stakes was 56% to 26%, while at the enterprises run by the same CEO for over 10 years, it was nearly just the opposite - 33% to 58% (see Table 3). In the same way, at the enterprises where the present chairman of board of directors had held his or her post less than one year, 48% of shares belonged to outside shareholders, and only 32%, to insiders. On the other hand, at the enterprises where the present chairman of board of directors had held his or her post over five years, the stake of outside shareholders was only nearly a half of the stake of insiders: 35% against 58% (see Table 4).

*Business Performance*

**Table 3**  
**Ownership Structure at Enterprises with Different Tenure of CEOs,**  
**2001, 2003, %**

Groups of enterprises by tenure of CEOs	2001					2003				
	owner types					owner types				
	insiders	outsiders	state	other	total	insiders	outsiders	state	other	total
Less than one year	26	56	12	6	100	26	56	5	13	100
1-5 years	38	49	11	2	100	39	49	7	5	100
5-10 years	52	34	6	8	100	52	41	4	3	100
More than 10 years	57	33	6	4	100	58	33	3	6	100
Total	48	40	8	4	100	47	44	4	5	100

**Table 4**  
**Ownership Structure at Enterprises with Different Tenure of**  
**Chairmen of the Boards of Directors, 2001,2003, %**

Groups of enterprises by tenure of chairmen of the boards of directors	2001					2003				
	owner types					owner types				
	insiders	outsiders	state	other	total	insiders	outsiders	state	other	total
Less than one year	41	50	6	3	100	32	48	8	12	100
1-5 years	49	41	5	5	100	45	48	5	2	100
5-10 years	51	41	7	1	100	58	35	1	6	100
Total	48	40	8	4	100	47	44	4	5	100

Quite expectedly, a top executive's tenure turns out to be longer at enterprises with disperse distribution of shareholdings, and shorter at enterprises where the first largest owners hold control (majority) stakes (see Table 5). In 2003, at the enterprises where the largest shareholder owned not more than 10% of all shares, the average tenure of CEOs was 13 years, and the average tenure of the chairman of the board of directors was 4 years. Meanwhile, at the enterprises where the largest shareholders owned a controlling stock (more than 50%), the same indicators were 9 years and 3.6 years respectively.

**Table 5**  
**Average Tenure of CEOs and Chairmen of the Boards of Directors at Enterprises with Different Stakes of First Largest Shareholders, 2001,2003, years**

Groups of enterprises by size of single largest block of shares	Average tenure of CEOs, years		Average tenure of chairmen of the boards of directors, years	
	2001	2003	2001	2003
Less than 10%	9.4	13.0	3.3	4.0
10-25%	12.5	9.1	3.6	3.5
25-50%	9.4	9.3	4.0	3.3
More than 50%	8.3	9.0	3.2	3.6

**Table 6**  
**Gross Intensity of Share Redistribution at Enterprises with Different Tenure of CEOs and Chairmen of the Boards of Directors, 1999-2003, %\***

Groups of enterprises by tenure of CEOs or chairmen of the boards of directors	1999-2001		2001-2003	
	CEOs	Chairmen of the boards of directors	CEOs	Chairmen of the boards of directors
Less than one year	53	40	58	56
1-5 years	39	39	47	38
5-10 years	36	30	45	40
More than 10 years	32	-	35	-

*"Gross intensity of inter-group redistribution of shareholdings is defined as:*

$$M = 0.5 \sum |d(t) - d(t-2)|,$$

*where M - percentage of shares that have "migrated" from one groups to others during two-year interval, and d(t) and d(t-2) are shares of group i in the equity capital of the relevant enterprise in the years t and t-2 (the factor 0.5 is used in order to avoid double counting since sums of positive and negative changes are equal by definition).*

Finally, replacements of CEOs and chairmen of the boards of directors seem to be usually preceded by substantial inter-group reallocation of shareholdings (see Table 6). At those enterprises where top management had been replaced during the year preceding the

### *Business Performance*

survey, gross intensity of inter-group redistribution of shares was near 60%, while it was no higher than 30-35% at the enterprises with strongly "entrenched" top executives.

The obtained results prove that a fairly close relationship exists between the two factors - changes in shareownership structure and renewal of management. Moreover, in the Russian context, this relationship looks quite "standard" as one might expect: insider dominance, dispersion of equity among numerous minor holders and "frozen" ownership structure provide a negative impact on the turnover rate, contributing to "entrenchment" of top managers.

As far as origin of top executives is concerned, incumbent management still prevails at Russian industrial enterprises (see Table 7). In 2003, two thirds of CEOs were incumbents and only one third came from outside. However, every second chairman of a board of directors was an outsider who had not worked at the enterprise before the appointment (see Table 8).

**Table 7**  
**Distribution of Respondent Enterprises by Tenure and Origin of CEOs, 2001, 2003, %**

Groups of enterprises by tenure of CEOs	2001		2003	
	Incumbents	"Strangers"	Incumbents	"Strangers"
Less than one year	43	57	47	53
1-5 years	72	28	58	42
5-10 years	79	21	81	19
More than 10 years	70	30	70	30
Total	69	31	67	33

The origin of top executives has obviously differed according to the date of their coming to power: in comparison with the "old" appointments, the "new" ones are much less likely to be recruited from incumbents (see Tables 7-8). For example, among the newcomers who took the CEO post no earlier than a year ago, less than 50% had worked

at the enterprise in the past, while among the "old-timers" who took this post from 5 to 10 years ago, about 80% had (see Table 7).

**Table 8**  
**Distribution of Respondent Enterprises by Tenure and Origin of Chairmen of the Boards of Directors, 2001, 2003, %**

Groups of enterprises by tenure of chairmen of the boards of directors	2001		2003	
	Incumbents	"Strangers"	Incumbents	"Strangers"
Less than one year	20	60	32	68
1-5 years	57	43	51	49
5-10 years	64	36	71	29
Total	63	37	52	48

A still more striking contrast between "newcomers" and "old-timers" was typical of chairmen of the boards of directors: incumbents accounted for 20-30% of the formers and 65-70% of the latter (see Table 8). This means that channels of recruiting of top executives at Russian industrial enterprises are becoming increasingly external, and consequently, the share of incumbents is gradually shrinking. The data presented in Table 7 provide another interesting observation: they suggest that the incumbents were surprisingly *less* dominant in the Soviet era than in the first phase of transition. However, this is hardly surprising, taking into account the very heavily insider-biased way of the Russian privatization.

Origin of top executives appears to be also related to characteristics of ownership structure. As follows from Table 10, managers and workers were holders of a majority of shares at the enterprises where incumbents were chairmen of the boards of directors, while outside shareholders owned the majority at the enterprises run by "strangers". Average size of insiders' stake reached 60% in the equity of the former, and slightly above 30% in the latter. Stock belonging to outside shareholders was distributed in a reverse pattern: their stakes were twice as large in the cases when a "stranger" headed the board of directors than in the cases when the chairmen of the board of directors

*Business Performance*

were incumbents. On the other hand, the origin of the CEOs was rather weakly related to the ownership profile (see Table 9).

**Table 9**  
**Ownership Structures at Enterprises with Different Origin of CEOs, 2001, 2003, %**

Owner types	2001		2003	
	Incumbents	"Strangers"	Incumbents	"Strangers"
Insiders	49	48	43	43
Outsiders	42	34	49	49
State	4	14	4	6
Other	5	4	4	2
Total	100	100	100	100

**Table 10**  
**Ownership Structures at Enterprises with Different Origin of Chairmen of the Board of Directors, 2001, 2003, %**

Owner types	2001		2003	
	Incumbents	"Strangers"	Incumbents	"Strangers"
Insiders	60	28	60	31
Outsiders	34	57	32	55
State	4	8	1	8
Other	2	7	6	6
Total	100	100	100	100

The relationship between concentration of ownership and the origin of top executives seems to be more ambiguous (see Table 11). The higher is the concentration, the more probably the board of directors is to be headed by an outsider (see Table 11). When the stake belonging to the largest shareholder is no more than 10%, the board of directors is nearly always headed by a former employee of the enterprise, while this is observed in less than a half of all cases where this stake is over 50%. In contrast, the relationship between concentration of ownership and the origin of CEOs is practically non-existent.

**Table 11**  
**Percentage of Companies with "Incumbent" Top Executives by**  
**Size of the Single Largest Block of Shares, 2001, 2003, %**

Groups of enterprises by size of single largest block of shares	Percentage of enterprises with incumbent CEOs		Percentage of enterprises with incumbent chairmen of the boards of directors	
	2001	2003	2001	2003
Less than 10%	64	43	92	100
10-25%	64	58	72	54
25-50%	76	73	56	43
More than 50%	55	53	29	43

Finally, we could find no evidence that could prove the dependence of origin of top executives on the intensity of the inter-group redistribution of shares (see Table 12).

**Table 12**  
**Gross Intensity of Share Redistribution at Enterprises with**  
**Different Origin of CEOs and Chairmen of the Boards of Directors,**  
**1999-2003, %\***

Groups of enterprises as depending on the origin of top executives	1999-2001		2001-2003	
	CEOs	Chairmen of the boards of Directors	CEOs	Chairmen of the boards of Directors
Top executive-incumbents	35	34	43	48
Top executive-"strangers"	43	41	43	39

\* *Gross intensity of inter-group redistribution of shareholdings is defined as:*

$$M = 0.5 \sum |d(t) - d(t-2)|,$$

where **M** - percentage of shares having "migrated" from one groups to others during a two-year interval, and **d(t)** and **d(t-2)** are shares of group **i** in the equity capital of that enterprise in the years **t** and **t-2** (a factor 0.5 is used in order to avoid double counting since sums of positive and negative changes are equal by definition).

On the whole, the REB surveys clearly demonstrate that the make-up of top management at Russian industrial enterprises remained fluid all

*Business Performance*

over the post-privatization period. Naturally, the critical issue is whether the observed changes were conducive to efficiency or not.

However, the REB data allow us to draw a generally comprehensive and consistent picture. As we could make sure, in the Russian context, insider ownership, low level of concentration, and low speed of inter-group redistribution of shares, as a rule, work in favor of long tenure for general directors and chairmen of the boards of directors, as well as benefit nomination of incumbents to these posts. They imply that, in the Russian context, insider shareholdings, low ownership concentration, and low speed of inter-group redistribution of shares, as a rule, contribute to longer tenures of general directors and chairmen of the boards of directors, as well as to nomination of incumbents to these posts. On the contrary, high ownership concentration and high speed of inter-group redistribution of shares, as a rule, help renew top executives and create favorable conditions for the advent of outsiders.

**NOTES**

[1] Changes in ownership structure of Russian industrial enterprises were analyzed in detail in our previous paper: S. Aukutsionek, N. Dyomina, R. Kapelyushnikov. Ownership Structure of Russian Industrial Enterprises in 2003. - The Russian Economic Barometer", 2003, vol. XXII, N 3.

[2] However, it is worth noting that "the inner balance of power" in this group has rapidly changed. If initially workers ownership dominated, in a while the largest block-holders became managers. In 2003, their cumulative stake was much larger than that of workers (26% against 21%). Moreover, the REB respondents' expectations were that in the next two years, managers' shareholdings should grow further and reach about one third of the total stake in 2005.

*to be continued*