Reply to the Discussion on “Top management turnover, firm performance and government control: Evidence from China’s listed state-owned enterprises”

Fang Hu

Department of Accounting, Finance and Economics

Griffith Business School, Griffith University

Email: f.hu@griffith.edu.au

Sidney C. M. Leung

Department of Accountancy, College of Business,

City University of Hong Kong

Email: acsleung@cityu.edu.hk

1. Introduction

We are grateful to the discussant for her detailed comments and helpful suggestions for our paper. While she recognizes the importance of the issues addressed in our paper, the discussant has concerns with: (1) the limitation of data and (2) arguments with respect to complicated government incentives for businesses in emerging markets. We respond to her concerns as follows and propose the potential future research in this area.

2. Some concerns

2.1. Limitation of data

The discussant indicates that the China Stock Market and Accounting Research (CSMAR) database provides some, but not exhaustive, reasons for management turnover. The discussant argues that the management turnover attributed to reason 9, improvement of corporate governance, or 10, criminalities, may be not triggered by poor performance. Similarly, other reasons disclosed—such as 1, rotation, 5, resignation, or 8, personal, -- may be due to some considerations other than firm performance. We totally agree with the discussant that it is extremely difficult to distinguish comprehensively between forced and non-forced turnovers based on publicly available information because very few press reports indicate clearly whether a turnover was voluntary or forced. It is a limitation many researchers in management turnover studies have recognized (e.g., Chang & Wong, 2009; Denis, Denis, & Sarin, 1997; Engle, Hayes, & Wang, 2003), and our study is no exception. We believe our approach to identify non-natural (or forced) turnover of top managers by

excluding turnover events in which a top manager left because of retirement, health reasons, change of ownership, or the end of a temporary appointment to the position, all of which are natural reasons of turnover not relating to firm performance, is suitable. If some turnovers of CEOs after 2001 are due to the recommendation by China Securities Regulatory Commission (CSRC) that listed firms should separate the CEO and chairman positions to improve their corporate governance rather than due to poor performance, as suggested by the discussant, we should not observe the documented negative relationship between management turnover and performance, and such situations should bias against our findings.

In addition, the discussant points out that the CSMAR database does not provide further information on whether turnovers are a result of promotions or demotions. The management turnover in firms may be a result of getting fired, getting promoted to the parent company, or being moved to a government post. The unavailability of data limits our ability to conduct further analysis along this line. We acknowledge this concern in the paper and suggest that future research could examine the management turnover-performance relationship in Chinese SOEs by tracing the departed chairman or CEO's next appointment. This approach will provide a deeper understanding of the managerial labor market in Chinese SOEs and the relation between the promotion/demotion of top manager, firm performance, and government control.

2.2. The incentives of government

The discussant agrees with our explanations that the state shareholder of SOEs may be more interested in economic performance than other objectives due to the fiscal decentralization

and yardstick competition policies adopted by the Chinese government. However, she also points out that our findings that government control complements corporate governance in an emerging market are not consistent with previous research (e.g., Kato & Long, 2006; Wang, 2010). Kato and Long (2006) argue that SOEs often have to sacrifice economic performance to achieve other “higher” social goals, such as full employment. The discussant indicates that it is difficult to determine the weight given to economic goals and other objectives, such as the political and social goals of government.

Our response is that while we recognize the complexity of government multiple incentives, the Chinese government appears to value SOE economic performance heavily and strategically for the following reasons. First, in spite of the criticisms that the Chinese economy lacks a functioning capital market and significant investor protection and is subject to extensive government influence and control, China has experienced remarkably rapid economic growth in the last two decades, largely supported by the success of China’s SOEs. Second, the previous research provides theoretical support that government involvement or regulation may be a suboptimal method to ensure efficient corporate business activity in an undeveloped economy that lacks strong legal protection for investors, a functioning capital market, and litigation risks (Shleifer & Vishny, 1997; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). Third, the Chinese central government has adopted fiscal decentralization and yardstick competition policies.

2.3 Others

The discussant points out that when the interaction term (Performance*GC) is introduced in

the regression model, the coefficient of performance becomes insignificant (see Table 4). In our opinions, those results are not conflicting with the test results for Hypothesis 1 that management turnover is significantly negatively associated with preceding firm performance. It is plausible that the efficient corporate governance, that is, a negative performance-turnover relation, mostly exists in the SOEs under tighter government control, which is consistent with our complementary effect hypothesis.

3. Summary

We appreciate the discussant's helpful suggestions. In order to provide a better understanding of the managerial labor market and corporate governance mechanisms in Chinese SOEs, which are still subject to significant government control, her comments call for additional rigorous research on a deeper understanding of incentive mechanisms in Chinese SOEs. Future research could examine the management turnover-performance relationship in Chinese SOEs by tracing the departed chairman or CEO's next appointment.. Another research direction is to evaluate the economic consequences of management turnover as a result of poor performance, such as subsequent firm performance and corporate governance structures.

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