Determinants of CEO Turnover in Transition Economies: Vietnam as an Ideal Case

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The lessons drawn from successful companies during 100 years past show that the management improvement, not the technology one or any others, has brought the outstanding development. According to the studies in transition countries, CEO turnover are more likely under influences of firm performance, ownership structure and board of management. In this article we have review the literature on CEO turnover from prior studies in both developed countries and transition countries. Those studies provide useful concepts in understanding the determinants of CEO turnover in Vietnam. They have contributed into the development of and improvement in the management in the current Vietnam joint stock companies and ensured the stable development of those businesses and the common development of economy in the context of equitization of state enterprises.

Keywords: Chief Executive Officers (CEO), turnover, corporate governance, transition economies.

1. INTRODUCTION

According to the studies in transition countries, CEO turnover are more likely under influences of firm performance, ownership structure and board of management. However, there is lack of clear studies on CEO turnover undertaken in Vietnam. Therefore, implementation and examination a variety of addressed determinants of CEO turnover are significantly important.

This paper provides several propositions around CEO turnover. The most important one is about relationship between CEO turnover and firm performance. Besides, the paper brings out the question on determinants of CEO turnover in Vietnamese enterprises. The article focuses on investigating and evaluating the management of joint stock in Vietnam currently and assesses the role of internal control, risk management and internal audit to businesses (DN) during the process of equitization and international integration… Those studies have contributed into the development of and improvement in the management in the current Vietnam joint stock companies and ensured the stable development of those businesses and the development of economy in the context of equitization of state enterprises.

2. THEORETICAL BASES AND RESEARCH METHODS

a. Theoretical Bases

Chief Executive Officers (CEOs) play an important role in determining many corporate polices and are arguably the most visible representatives of the firm to investors. The relationship between CEO and board of directors who represent shareholders leads to agent-principle problems. Practically, the agent-principle problem occurs when a conflict of interests, or transaction costs, exists between members within a corporation. Those create the governance problems in corporations (Hart, 1995). Therefore, corporate governance is important and necessary in situations where there is an agency problem, a conflict of interests, or exchange costs are involved. In general, corporate governance mechanisms include control by the board of directors, struggle over agent rights, hostile takeovers by large shareholders, and a company's financial structure. Especially, shareholder delegation of the power to fire the CEO to the board of directors is central to corporate governance. However, board of directors is influenced by its characteristics such as board independence (Hermalin and Weisbach, 1998; and Bhagat and Black, 2002), stock ownership of board members (Bhagat, Carey, and Elson, 1999), and CEO duality (Brickley, Coles, and Jarrell, 1997). Therefore, the decision of CEO dismissal seems to be very complex. Besides, board of directors may not be the only disciplining authority of the CEO. As a result, management changes could be a result of the monitoring by large block holders or potential competition among managers (Warner et al., 1988; and Harrison et al., 1988).

It is consistent with the statement of Yang (2007) that CEO turnover is influenced by and influences many aspects of corporate governance. Furthermore, Volpin (2002) and Gibson (2003) agreed that a good corporate governance system may be reflected by a higher CEO turnover-performance sensitivity. Thus, CEO turnover is important to the development of corporations (Chang and Wong, 2009).

Also, the relation between CEO turnover and firm performance has gained more concern. As a result, later studies agreed that CEOs are indeed more likely to be forced out of their job if their performance is poor related to the industry average (Boone et al., 2007; Linck et al., 2008). Indeed, CEOs are responsible for the performance of the firms they lead. Hence the likelihood of forced CEO turnover seems to increase when the firm performance declines. The evidence is found in all major markets in the world, such as the U.S. (Huson et al., 2001), the U.K. (Conyon and Florou, 2002), Japan (Kaplan, 1994a), and Germany (Kaplan, 1994b).

In regard to the role of board of directors in making decision on CEO dismissal, many studies evaluated the effects of board characteristics on CEO turnover decision. For instance, Barkema and Gomez-Mejia (1998) indicated the four board characteristics, which include board size, board composition, board tenure and leadership structure, do affect the CEO turnover decision. Together, Coles et al. (2008) mentioned that characteristics, size and structure of board influence CEO turnover. In fact, prior studies on board characteristics suggested that the link CEO turnover-firm performance correlate to the characteristics of board. In detail, Brunello, Graziano, and Parigi, (2003), and Bushman, Dai and Wang (2010) stated that the fraction of outsiders on the board will increase the sensitivity of CEO turnover to performance. Moreover, Hwang and Kim (2009), and Masulis and Mobbs (2009) evaluate the independence of board and report that the independence of board is able to lower agency costs and reduce managerial entrenchment.

Many studies have revealed that CEO turnover is important to the development of corporations (Chang and Wong, 2009). Additionally, CEO turnover influences many aspects of the corporation (Yang, 2007). In detail, those studies have pointed out several determinants of CEO turnover which include firm performance, ownership structure, firm size, characteristics and size of board, or political relationship (Van Dalsem, 2010). Many prior studies on the relationship between CEO turnover and firm performance have documented that CEOs are indeed more likely to be forced out of their job if their performance is poor related to the industry average (Fredrickson, Hambrick and Baumrin, 1988; Boone et al, 2007; Linck et al, 2008). Chi and Wang (2009) document that CEO turnover is almost researched in Western countries, especially in developed countries. In regard to Djankov and Murrell (2002), research on CEO turnover is an attempt to improve enterprise performance in Western countries. However, the picture in transition and emerging economies are less clear-cut as many institutions of corporate governance remain underdeveloped in these countries. Although developing and transition countries have received a little attention on CEO turnover, there are several studies have attempted to contribute to the literature.

The general remark from those researches shows that the CEO turnover reveals a clear and close relationship between CEO competence and corporate governance. The lessons drawn from successful companies during the past 100 years show that the management improvement, not the technology one or any others, has brought the outstanding development to companies.

Nowadays, almost regulations and proposals of business management have been built basing on the lesson from Asian financial crisis in 1997. Besides that, the collapse of Enron Group in the end of 2001 is the background for the birth of Sarbanes-Oxley Law regulating those requirements of a good business management. European countries have also produced regulations similar to American Sarbanes-Oxley Law but are loosen. While Far Eastern countries, after consulting regulations issued by the United Kingdom, amend and modify them to fit with their own economic conditions. In any cases, those new regulations also bring a new trend and meaning for the business management.

The reality shows that most of lessons drawn from US and European financial crisis mainly are the role of corporate governance, especially the internal control, and the bad affect of those failures that created the crisis. With the development of global investment and finance as it is now, in order to ensure effective attraction of domestic and foreign investors, the law makers must ensure that the regulations on business management and legal framework must be suitable with the international practices and major members of capital market must follow and agree with those regulations as well. Moreover, with the increasing competition for investments in the period after the global financial crisis, it is essential to make tightening regulations on management to improve the competitiveness, and efficiency of the effort to attract investment flows to an emerging economy as Vietnam.

b. Research Methods

Experimentally, studies of CEO dismissal in the developed countries and countries in transition period to market economy will assess trends of each pair of comparable targets (for example: Among the developed countries in European region, or between the developed and developing countries, etc.) thereby determining the measure and progress of the different trends.

For the group of developing countries, studies of CEO dismissal in the developed countries will be evaluated, analyzed and compared to deal with the question of whether best regulations and rules of corporate governance introduced by developed countries are appropriate or not, especially in the recent period of successive crises, from Asian financial crisis in 1997 to public debt crises in 2011 and 2012.

For the group of developed countries, in-depth studies of CEO dismissal may provide a clearer view on the management of joint-stock companies, especially in Vietnam today. The studies of CEO dismissal will be analyzed under the perspective of business management with the legal framework and operational practices as variables to grasp business administration and management capabilities of Vietnamese CEOs.

In fact, Vietnamese trends of development and integration has now not only opened up many opportunities and favorable conditions for development of domestic enterprises, but also created many challenges, forcing enterprises to change and improve themselves incessantly to suit the new situation.

These questions contribute to the development of and improvement in corporate governance among Vietnamese joint-stock companies at present, thereby ensuring the sustainable development of enterprises and the whole economy in the context of equitization of SOEs and development of market economy as supported by the Vietnamese Government.

The comparison of the correlation between two variables (developed and developing countries) is based on three trends of the concept of “decoupling”: “no decoupling”, “relatively decoupling”, and “absolute decoupling”.

CEO turnover variable in developing countries tends to move to improvement in the legal framework and operational practices if there is a trend towards relatively decoupling or absolute decoupling compared to CEO turnover variable in developed countries. This means that the requirements and situation of corporate governance and managerial competence of CEOs in developing countries are relatively different from those in developed countries, and thus requiring specific and appropriate practices and know-how.

Based on the analyses of corporate governance and CEO turnover possibility, the study has selected a number of indicators measuring the situation of corporate governance and the possibility of CEO turnover in Vietnamese enterprises. These indicators have some minor adjustments compared to the research of scholars in the world to fit the context of Vietnam and data sources for research.

3. CORPORATE GOVERNANCE AND CEO TURNOVER IN VIETNAM

a. Determinants of CEO Turnover in Vietnam:

According to Steer and Sen (2010), Vietnam provides an appropriate empirical context as a transition economy. In the past few decades, Vietnamese economy has seen significant economic growth and rapid poverty reduction. Along with the growth in economy, the unique corporate governance mechanism has been receiving more attention. In fact, Vietnamese corporate governance has borrowed from the two most effective corporate governance mechanisms in the global markets, the Anglo-American and the German corporate governance structures (Bui, 2006; Le Minh and Walker, 2008; and Bui and Nunoi, 2008). It results in a combination of these two models in Vietnamese corporate governance mechanism which includes the Board of Directors and the Control Board. In the model, two monitoring organs are coexistence. One is independent directors which adopted from the Anglo-American corporate governance structure. The other one is the Control Board which is from the German model.

The Control Board in Vietnamese system is not engaged in daily operation management and is responsible for monitoring the behaviors of executives and the BOD (Bui and Nunoi, 2008; and Le Minh and Walker, 2008).

Besides, board independence has significant impacts on firm performance and CEO turnover (Weisbach et al. 1988; Yermack, 1996; Hermalin and Weisbach, 2003; Hwang and Kim, 2009; and Masulis and Mobbs, 2009). Hence, studying CEO turnover as a result of corporate governance practices could provide ideas for improving the corporate governance systems.

Weakness of internal supervision: From the legal point of view, the Companies Law 2005 recognizes the supervision function of Control Boards. In fact, the Control Board is responsible for supervising the BOD and other managers in an enterprise (Le Minh and Walker, 2008). However, activities of the Control Board are rarely based on requests made by shareholders, especially minority shareholders. Since, members of a Control Board are workers in their enterprise and seem to work in a part-time manner.

Therefore, the members might pay more attention on their main job rather than supervising performance of people of high positions in their enterprises. It can be understand that member of Control Board might depend on the members of BOD and CEO. Thus, the independence of Control Board is weak. Besides, Control Board members seem to have lower positions than members of BOD even though both of them are elected by shareholders. As a result, most members of BOD are often majority shareholders.

Hence, it shows that the distinction between ownership and management is unclear. Furthermore, this unclear distinction has weakened the establishment and operation of the Control Board.

To conclude, the current structure of the Control Board creates difficulties in fulfilling successfully its tasks. Indeed, the operation of the Control Boards in Vietnamese enterprises seems to be more formalistic and to perform as department while decisions by BOD and CEO are legalized. The dependence of Control Board has weakened its function in supervising the BOD and CEO in order to protect the interests of shareholders.

In fact, Vietnam has also witnessed a number of enterprise scandals which are results of poor corporate governance. These scandals have involved some of the largest enterprises in Vietnam. The reason for these scandals is indicated as weak internal corporate governance in Vietnamese enterprises. Indeed, a weak internal corporate governance system can be evaluated via the internal disciplinary mechanism that determines CEO turnover (Cai and Chen 2004; Kato and Long, 2006). Generally, there is a lack of effective market for corporate governance, it weakens the internal corporate governance.

Besides, Vietnam still has the poorly defined property right and weak investor protection, especially minority investors (Bui and Nunoi, 2008, Tran et al., 2010). Thus, these can make agency problems occur in Vietnamese enterprises. Indeed, Volpin (2002) documented the agency problem in Italy by studying top executive turnover in the absence of strong investor protection.

Therefore, Vietnam is an appropriate case for a study of internal corporate governance including the link CEO turnover-firm performance. As a result, it could evaluate the investor protection and agency problems in a transition economy where the majority shareholders are often the state with a complex set of objectives.

b. Corporate Governance and CEO Turnover in Vietnamese Companies:

In Vietnam, the regulatory basis for business management relating to capital market is Decision 12/2007/QĐ-BTC (Decision 12 for short) issued by Ministry of Finance on March 13, 2007 to provide Regulations on company management applied for listed companies and Decision 15/2007/ QĐ-TTL (Decision 15) by State Securities Commission on implementation of stockholder rights. While Decision 12 provides specific regulations on all fields of business management which must be followed by listed company in order to ensure a powerful, transparent and independent management system, Decision 15 deals with the implementation of rights for shareholders and investors in listed companies. Before the Decision 12 was issued, many requirements relating to business management had been stated in Companies Law and Securities Law.

Up till now, after 25 years of economic reform, many Vietnam businesses have been listed to the stock market. The fact shows that the framework of business management in Vietnam has been regulated in Companies Law, Securities Law and implementation guidance documents. Besides that, Ministry of Finance have issued the Regulations on corporate governance and the sample articles of incorporation used for listed companies in Vietnam. Basically, there was a general legal framework for business management, creating an important basis for businesses in building regulations for their own management. This has brought significant efficiency in business activities of companies.

Although a legal framework for corporate operations is basically in place but in practice, many problems are not adjusted properly by law. That is the reason why many shareholders, especially small shareholders in joint stock companies and other interested parties often make pressure to force the company to make regulations for their own business management.

The corporate regulations on business management are often based on provisions of current law and include its own rules to fit characteristics of the company and expectations of shareholders and other relevant parties. Moreover, both shareholders and relevant parties, and the Board of Directors and managers also tend to build a proper business management statute to help the company operate professionally and transparently in order to improve reputation and attract the attention of other investors. However, due to the awareness of business management has still been limited and the deliberate misunderstanding the nature and significance of business management, many regulations on business management are too vague meet requirements posed by international principles of business management and expectations of shareholders and relevant parties.

Assessing the role of internal control is an indispensable daily activity in business management, applied to any businesses, regardless of size or field of activity. Nowadays, companies have realized the importance of internal control, and an effective system of internal control will help businesses avoid unexpected risks and serve as a foundation to help businesses operate efficiently, safely and sustainably. Although it is used everyday, the internal control concept has not been well understood and properly applied in many Vietnamese businesses. Consequently, the internal control system does not promote its own effectiveness and limit the efficiency of business as well.

Lessons drawn from companies that lack effective systems of internal control are very easy to find. According to information provided by Liên Việt Securities Company (LVS), in early 2011, Hoàng Xuân Quyến – LVS Director General - signed illegally a contract mortgaging OTC shares to provide a customer with a big loan, then the customer breached the contract and did not pay the debt causing financial losses for LVS. This is an activity that is not allowed by LVS Board of Directors. According to LVS, Mr. Quyến's main faults are acts of signing the loan agreement without the permission of the Board and violating regulations and provisions of the LVS. A financial loss is a lesson that helps LVS realize the hole in business management.

In fact, many companies in Vietnam lack awareness of the importance of the internal control or do not build internal control systems. These companies are usually in the period of transition from the old mechanism to a new operating system; or they are newly established businesses that are struggling to survive in a more competitive environment.

Researches show that Vietnamese companies should pay full attention to certain "symptoms" to detect problems with their internal control system. The most obvious symptom is "inconsistency" that are widespread among companies lacking bylaws and clear operating procedures, and depending too much on verbal orders from directors. In manufacturing companies, the fact that employees of purchasing department accept any salary level is never a good thing. Other symptoms are overlaps between departments, poor communication between departments, and recriminations. It is worse when CEOs feel doubtful about revenues and expenditures, performance of accounting department, or actual receivables from goods sold.

4. CONCLUSION AND POLICY IMPLICATIONS

Vietnam is regarded as an ideal case after studying and evaluating previous researches on decisions on CEO turnover. Many authors consider the firm performance as the main measurement for decision of CEO dismissal (Fredrickson, Hambrick and Baumrin, 1988; Boone et al., 2007; and Linck et al., 2008).

Since Vietnam switched to market economy (1986), regulations on business management have been quite simple compared with international practices. With the effort made by the Government to develop the private sector into a dynamic of economic development and a source of investments in the domestic capital market, the implementation of and improvement in the legal framework for business management became urgent with a view to reaching the best international practices and accepted regulations on corporate governance.

From the above remarks, we propose the following aspects of corporate governance that require improvements:

- Providing clear and specific responsibilities and duties of board members.

- Introducing regulations on appointment and dismissal of board members and on their functions, such as prevention, control and report on cases where conflicts of interests increase.

- Amending relevant articles in the Companies Law to allow Director General of the parent company to appoint general manager of the subsidiary where Director General is directly responsible for the financial strength and performance of the entire group.

- Providing clearer procedures for assessing the performance of each board member and CEO.

- Requiring the Board to make report on compliance by listed companies to current regulations on business management and the internal control system they have built.

- Introducing sanctions against failures to comply with regulations.

- Adding specific regulations on internal audit and risk management processes.

- Requiring the board members and key managers to take mandatory courses in corporate governance.

- Accounting standards to be promulgated should be more consistent with internationally accepted practices and standards. In addition, some provisions of the Securities Law should be amended to ensure that only companies that comply with laws are allowed to be listed, or stay in the list, on the stock market. Moreover, to facilitate transactions by companies and promote the growth of capital markets, authorities should quickly issue appropriate regulations relating to the merger and acquisition of companies.

- Enhancing and promoting internal control: With the diversification of business forms, the fast growth of sources of finance in each company, and especially the process of accelerating the market capitalization of the business environment in Vietnam at present, capital investors has gradually moved away from the management role. Therefore, a strong system of internal control becomes important and serves as an optimal instrument for determining the safety of investments, the efficiency of the corporate management board and the firm performance as well. To build a most suitable system of internal control for each company, first of all, it is necessary to identify the key characteristics of business, administration form, organizational structure, and relationship between departments, etc. Secondly, to set out a clear policy on internal control to help all board members understand the importance of the internal control system actively to corporate operations.

In fact, development and integration trends of Vietnam today have offered both opportunities for development and challenges that force companies to adjust themselves to cope with new changes. In this context, all companies must continuously improve their managerial skills and technologies to keep pace with new developments. For all companies, supervision and monitoring tasks are very important and internal control system is the main tools to carry out the tasks in all operations of the company. A strong system of internal control will contribute significantly to the success of businesses.

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