TENURE OF KEY U. S. EXECUTIVES

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Background

Recently, so much concern has been expressed regarding the lagging productivity and weakened competitive strength of U. S. firms in both domestic and international markets. Now there seems to be a general consensus that U. S. industry is facing a serious problem competing against foreign counterparts, especially Japan, in many key fields - steel, auto, electronics, etc.

What are the causes of the decline in the competitiveness of U. S. industry? A review of the various published studies in this area indicates the following as the causes:

--Greater dependence of diversified corporations on short-term financial measurements like ROI for evaluating managers' performance;

--An increase in excessively cautious managers' behavior characterized by an unwillingness to assume even reasonable risk;

--Customer-oriented behavior of managers that have largely ignored innovative product and process development;

--The lag in R & D investment and capital spending;

--Stock market myopia and managers' concern about sustaining stock prices and avoiding takeover threats;

--Short tenure and high mobility of managers;

--Insignificant amount of long-term compensation compared to short-term compensation; and

--Difficulty in identifying the interests of a diverse set of stockholders

All of these causes are related to one another and intertwined.

The single, most significant cause among these, nevertheless, is the short tenure and high mobility of managers. This characteristic of U. S. managers, in sharp contrast to that of Japanese managers who usually stay with the same employer for life, is seen by many as the main cause of the short-term view taken by U. S. managers.

In this paper we will analyze one aspect of the short-term perspective attributed to managers of U. S. firms - short tenure.

Short-Term Perspective

A short-term perspective can cause managers to over-emphasize immediate results and sacrifice long-term results. As a consequence, the absence of long-term success puts more pressure on managers to go to extremes to generate some short-term results while fighting to hold back ultimate failure. Oftentimes, these short-term extremes can amplify the impending long-term failure.

The short-term mismanagement of employees and customers are good examples. If a top level manager knows that he or she will be in a different company when the promises come due, they can promise anything to employees and customers to increase this year's profits. The management team that follows must pay for those

promises and be judged a failure for the lack of profits on "their watch". Consequently, a long-term perspective can only exist when the key decision makers will hold their positions for a long-term period.

Among all managers, two top level managers will not only have substantial influence, they will have the ability to prevent others from making unfortunate trade-offs. These two managers are the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO). The CEO has direct control of the operating policies and management incentives for all managers. The CFO has intimate knowledge of the operations and management control systems of the organization, and should be capable of detecting dysfunctional trade-offs. Most often, the CFO will also have direct access to key individuals on the Board of Directors and could circumvent short-term behavior of the CEO.

Length of Tenure

A manager's motivation to trade short-term performance for long-term performance will be strongly influenced by the manager's belief in the likelihood of how future rewards will be associated with the two types of performance.

A manager who will not be with the company the following year can enhance his or her performance record by trading labor a \$2 per hour wage reduction this year for a \$4 per hour increase next year. Not only is the manager's current year performance increased relative to last year, it looks more favorable than that of the manager who follows and must absorb the \$4 increase in labor cost. If the length of product warranties are extended from one to three years, consumers may respond by increasing their confidence and resulting purchases. The increase in current-year sales and profits will certainly be followed by a compensating reduction in profits in later years.

Failure to perform required maintenance on equipment causes much higher maintenance costs the following year. Failure to invest in employee training and development results in a less competent work force and reduces company efficiency and effectiveness. The management control literature is replete with examples of dysfunctional effects of short-term trade-offs.

Research Design

The purpose of this study was to determine the tenure of CEO's and CFO's in the 1985 Fortune 500 companies. Moody's Industrial Manuals [1976-1985] were examined for the ten-year period ending in 1985. Sufficient data was available to analyze 391 of the Fortune 500 companies.

Moody's Industrial Manuals included the names of the CEO's and CFO's for each of the years examined. The frequency of CEO and CFO turnover was analyzed by industry and by ten-year earnings per share growth rate. These data are presented in Tables 1 through 6.

Analysis of The Data

Table 1 shows the average number of years of tenure of key Fortune 500 executives, by industry classification. For all 391 firms included in the analysis, the average CEO has been the CEO for at least 6.26 years and the average CFO has been the CFO for at least 5.40 years. The true average should be higher than that indicated because of the number of people who held their position for years prior to the study period. A review of the statistics for each industry classification does not indicate the existence of a short tenure problem, but simple averages can sometimes hide underlying problems.

Table 2 arrays data indicating the number of times the CEO's changed during the ten year period under study. Overall, 42.5 percent of the companies

TABLE 1
AVERAGE YEARS OF TENURE
OF KEY EXECUTIVES

INDUSTRY	CEO's	CFO's
Aerospace	6.23 years	6.68 years
Electronics	6.51	6.43
Computer	6.53	4.55
Chemical	6.16	5.36
Building Material	4.92	5.63
Beverages	7.06	5.46
Apparel	6.27	7.50
Metal Products	6.27	5.10
Jewelry *	9.00	9.00
Industrial Equipment	6.36	5.22
Furniture *	4.50	3.33
Food	5.73	5.26
Forest Products	6.86	5.94
Metals	5.71	4.77
Mining and Crude Oil	6.85	6.06
Motor Vehicles	5.14	5.27
Petroleum	6.05	4.73
Pharmaceuticals	6.49	4.56
Publishing	6.00	5.60
Rubber	5.47	3.51
Scientific	6.82	5.43
Soap & Cosmetics	5.98	5.88
Textiles	7.50	6.09
Tobacco	5.00	3.27
Toy	7.50	3.50
Transportation Equipment	6.44	5.75
Average	6.26	5.40

* n = 1

TABLE 2
CHIEF EXECUTIVE OFFICER TURNOVER
BY INDUSTRY

INDUSTRY	NUMBER OF FIRMS WHO HAD INDICATED NUMBER OF CEO CHANGES DURING TEN YEAR STUDY PERIOD							TOTAL
	0	1	2	3	4	5	>5	
Aerospace	7	4	3					14
Electronics	21	14	2	1				39
Computer	9	6	1	1				17
Chemical	13	16	4	1				34
Building Material	4	6	4	1				15
Beverages	6	2						8
Apparel	4	3	2					9
Metal Products	9	5	4	1	1	1		21
Jewelry	1							1
Industrial Equipment	10	16		2				28
Furniture	1							1
Food	8	18	2	2				30
Forest Products	12	5	4	1				22
Metals	7	10	2	2				21
Mining and Crude Oil	5	5						10
Motor Vehicles	3	6	3	1	1			14
Petroleum	11	12	1	1				25
Pharmaceuticals	8	6	2	1				17
Publishing	5	5	3					13
Rubber	2	6	2					10
Scientific	7	6	2	1				16
Soap & Cosmetics	3	1	2	1				7
Textiles	5	3						8
Tobacco	1	1	2					4
Toy	2	1						3
Transportation Equipment	2	1		1				4
Average	166	159	45	18	2	1	0	391
Percent	42.5	40.7	11.5	4.6	0.5	0	0	100.0

had the same CEO for the entire ten year period while 40.7 percent of the companies changed CEO's only once during the ten years. Only 5.3 percent of the companies changed CEO's more than twice during the ten years. These data fail to indicate that rapid CEO turnover has contributed to the problems American industry is experiencing today.

Table 3 shows similar data for the CFO's. Although the analysis shows more frequent turnover, 69.7 percent of the companies had less than two CFO changes during the ten years studied and only 11 percent had more than two changes in CFO.

The data in tables 1, 2 and 3 do not indicate that U.S. Fortune 500 companies have a problem with short tenure CEO's or CFO's. Moreover, these data only relate to the tenure of these executives in their current position with the company. It is highly possible that many of these executives have been employed in other positions by the same company for many years before becoming the CFO or CEO.

If the success of companies can be measured by their long-term profitability and if profitability can be scaled by measuring earnings per share, then long-term earnings per share growth should be an indicator of a company's success in business. The analysis of CEO and CFO turnover implies that high turnover should be related to short-term perspective and lower levels of company performance. One way to test this relationship is to analyze the earnings per share growth rate performance as a function of CEO and CFO turnover. If high turnover has a negative effect on company performance, then it should be highly correlated with lower earnings per share growth and a lower ranking in earnings per share (EPS) growth among the Fortune 500. The highest growth rate and highest rank is 1, and the lowest growth rate is ranked 500th.

Table 4 shows the percentage of companies in each EPS ranking range that had the number of CEO changes indicated. Of those companies who ranked as the highest 50 in ten-year EPS growth, 38.2 percent did not change CEO during the ten year study period, 41.1 percent changed CEO only once, and 20.6 percent changed CEO twice. None of the top 50 changed CEO's more than twice during the ten years studied. A review of the data in other EPS ranking groups indicates the lack of any meaningful trends. If a higher frequency of executive turnover is a cause of poor company performance, then one would expect higher CEO turnover rates to be negatively correlated with EPS growth rate.

Table 5 shows the same analysis for CFO changes and company EPS growth ranking. For companies ranked in the highest 50 for ten year EPS growth, 32.4 percent did not change CFO during the ten years studied, 50.0 percent changed CFO only once, 14.7 percent changed CFO twice, and 2.9 percent changed CFO four times. A review of the data for the remaining EPS growth rate ranking groups indicates no significant trends. The frequency of changing CFO's appears to be unrelated to the companies' ranking in ten-year EPS growth.

An analysis of average length of tenure for CEO's and CFO's by EPS growth ranking group is included in Table 6. Again, analysis of these data indicate lack of significant trends to corroborate the assertion that higher levels of executive turnover cause lower company performance.

Summary and Conclusions

If overemphasis on short-term results has caused U.S. companies to sacrifice their long-term success, and if this short-term perspective is at least partly caused by anticipated movement to another job or another company, then an analysis of the turnover of

TABLE 3
CHIEF FINANCIAL OFFICER TURNOVER
BY INDUSTRY

INDUSTRY	NUMBER OF FIRMS WHO HAD INDICATED NUMBER OF CFO CHANGES DURING TEN YEAR STUDY PERIOD							TOTAL
	0	1	2	3	4	5	>5	
Aerospace	8	5	1					14
Electronics	18	11	7	2	1			39
Computer	6	3	5	2	1			17
Chemical	12	11	7	4				34
Building Material	6	6	1	1	1			15
Beverages	3	3		1	1			8
Apparel	6	3						9
Metal Products	4	9	5	2	1			21
Jewelry	1							1
Industrial Equipment	8	12	5		2	1		28
Furniture		1						1
Food	8	10	10	2				30
Forest Products	8	9	4	1				22
Metals	6	4	6	1	2	2		21
Mining and Crude Oil	5	2	3					10
Motor Vehicles	4	4	3	2	1			14
Petroleum	4	16	3	2				25
Pharmaceuticals	2	10	3		1	1		17
Publishing	4	6	3					13
Rubber		3	5	2				10
Scientific	5	6	4	1				16
Soap & Cosmetics	3	1	2	1				7
Textiles	4	2		2				8
Tobacco		1	2	1				4
Toy		2						3
Transportation Equipment	1	3						4
Average	141	131	76	27	12	4	0	391
Percent	36.1	33.5	19.4	6.9	3.1	1.0	0	100.0

TABLE 4
EARNINGS PER SHARE GROWTH RATE
AND FREQUENCY OF CHIEF EXECUTIVE OFFICER CHANGES

FORTUNE 500 RANKING IN 10 YEAR EPS GROWTH RATE	PERCENT OF COMPANIES SHOWING INDICATED NUMBER OF CEO CHANGES						TOTAL
	0	1	2	3	4	5	
1 st - 50 th	38.2	41.1	20.6	0	0	0	100.0
51 st - 100 th	48.8	43.9	7.3	0	0	0	100.0
101 st - 150 th	38.9	36.1	22.2	0	0	0	100.0
151 st - 200 th	46.2	41.0	10.3	0	2.6	0	100.0
201 st - 250 th	37.5	50.0	9.4	3.1	0	0	100.0
251 st - 300 th	42.9	45.7	2.9	8.6	0	0	100.0
over 300 th	36.1	36.1	19.4	8.3	0	0	100.0

executives in key positions should provide evidence which tends to corroborate these assumptions. The evidence derived from a ten-year study of the 1985 Fortune 500 Companies fails to support these assumptions.

This should lead researchers to

concentrate more on other factors that may have contributed to U. S. industry's problems, such as those listed at the beginning of this article. Interpreted differently, the findings in our study may indicate that 6 to 7 years is not long enough to observe managerial performance.

TABLE 5

EARNINGS PER SHARE GROWTH RATE
AND FREQUENCY OF CHIEF FINANCIAL OFFICER CHANGES

FORTUNE 500 RANKING IN 10 YEAR EPS GROWTH RATE	PERCENT OF COMPANIES SHOWING INDICATED NUMBER OF CFO CHANGES						TOTAL
	0	1	2	3	4	5	
1 st - 50 th	32.4	50.0	14.7	0	2.9	0	100.0
51 st - 100 th	28.2	30.8	28.2	10.3	2.6	0	100.0
101 st - 150 th	28.6	20.0	31.4	14.3	5.7	0	100.0
151 st - 200 th	28.9	39.5	23.7	5.3	2.6	0	100.0
201 st - 250 th	33.3	42.4	18.2	3.0	3.0	0	100.0
251 st - 300 th	34.3	37.1	20.0	5.7	2.9	0	100.0
over 300 th	27.8	33.3	19.4	13.9	0	5.6	100.0

TABLE 6

AVERAGE LENGTH OF TENURE
COMPARED TO
EARNINGS PER SHARE GROWTH

FORTUNE 500 RANKING IN 10 YEAR EPS GROWTH RATE	AVERAGE YEARS OF TENURE	
	CEO	CFO
1 st - 50 th	6.06	5.80
51 st - 100 th	6.87	4.93
101 st - 150 th	6.14	4.87
151 st - 200 th	6.20	4.63
201 st - 250 th	5.59	5.70
251 st - 300 th	6.49	5.63
over 300 th	6.14	5.32
Overall Average	6.31	5.26