CEO Succession and Performance at Rural Banks

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Motivation

- Banks operating in rural areas face demographic and economic changes resulting in smaller local labor pools.
- If “talent” is correlated with performance, and is less accessible in rural communities, then replacement of managers at rural banks, compared to equivalent replacement at urban banks, could, over time, erode their competitiveness.

Key Findings

- CEO replacement at rural banks, relative to urban banks, does not require compromises that are evident in subsequent management performance as assessed by regulators.
- These results are inconsistent with the notion that rural banks are threatened by “talent migration” and therefore are unable to replace CEOs with the same effectiveness as urban banks.

Methodology

- We investigate differences in performance between urban and rural banks after CEO changes.
- We assume that managerial "talent" influences performance.
- Our key empirical advantage is access to confidential regulatory ratings of bank management that we use to identify performance outcomes.

The Sample

- CEO successions identified between 2003 and 2016
- 1,513 observations: 1,206 located in urban areas and 307 located in rural areas
- Bank-specific and publicly-available data are also obtained from Reports of Condition Income (Call Reports).

Hypothesis

- Hypothesis 1: Banks experiencing CEO succession in urban areas exhibit shorter times to upgrade in management rating compared to those in rural areas
- Hypothesis 2: Banks experiencing CEO succession in urban areas will experience longer times to downgrade in management rating

Model Specification

- Utilize an Accelerated Failure Time (AFT) model, part of the survival analysis field of statistics and commonly used in epidemiology
- Change in management rating is a proxy for a change in the “health” of the institution
- Key covariate is bank location in a rural area
- We determine the significance of rural on the improvement or decline in performance after introduction of the CEO change.

Model Results

- Empirical tests reject both hypotheses.
  - Hypothesis 1: Coefficient of Rural is negative and statistically significant at the one percent level
  - Hypothesis 2: Coefficient of Rural is positive and statistically significant at the one percent level
- Urban banks are not slower to experience downgrades, or quicker to experience upgrades than rural banks, in regulatory-assessed management ratings.

Conclusions

- Our results, collectively, are inconsistent with the notion that rural banks are unable to replace CEOs with the same effectiveness as urban banks.
- The findings suggest that problems rural banks encounter in the future will not necessarily be aggravated by succession difficulties.