Local supply of managerial skills can impact firm performance

March 15 2023, by Fabio Todesco

Credit: Unsplash/CC0 Public Domain

If you think that the executive labor market is a global one, you're not alone. After all, it's pretty common to read about top managers being hired to steer the fate of far-away companies. However, recent research by Julien Sauvagnat (Bocconi Department of Finance) and Fabiano Schivardi (LUISS) highlights that local supply of managerial talent is an underestimated driver of company performance, and that local policies aimed at boosting growth should boost the supply of leadership skills.

In "Are Executives in Short Supply? Evidence from Death Events," an article in *The Review of Economic Studies*, the two scholars analyzed INPS (Italy's social security bureau) data for the entire population of Italian private sector workers from 2005 until 2015 and matched it with the companies' balance sheets.

"We first documented that both firms and executives disproportionately target their searches within the same industry and geographic area," Professor Sauvagnat said, "arguably due to mobility costs and industry-specific human capital."

To better understand the role of the local supply of managerial skills, the authors observed what happens to corporate performance when an executive ("dirigente" in Italian labor legislation) dies.

Confirming that managerial skills matter, they found that ROA (Return On Assets) declines by an average of about 0.8 percentage points in the year of death and in the following three years—an economically significant impact when compared with the average ROA of 4%. The loss is estimated to be €759,000 per firm each year, mainly driven by a decline in sales.

Upholding the importance of the local supply of managerial skills, however, they found that the effect is driven by the drop in performance at firms operating in "thin" managerial job markets, i.e., markets where the local supply of executives with experience in the same industry is scarce. ROA at these firms decreases by 1.8 percentage points.

"Managers hired following the death of an executive in 'thin' local markets have lower education and experience levels than those hired in non-thin markets," Prof. Sauvagnat explained, "and they are also more likely to leave the firm over the next few years, consistent with the idea that the short supply of executives in the local labor market generates manager-firm pairings of lower quality."

Even when the exit of an executive is planned, as in the case of retirement, firms pay a price to the shortage of local executive talent, but the effect is weaker (-0.5 percentage points of ROA for two years). Nothing similar is recorded, however, for the expected or unexpected exit of middle managers ("quadri").

"These results can plausibly be extended to other types of shocks that require firms to quickly acquire new types of skills in the marketplace—for example an unexpected, large business opportunity in an unexplored market," Prof. Sauvagnat concluded, "and they seem to be generalizable to job markets outside of Italy, since international comparisons show that the Italian labor market is not an outlier in terms of labor and worker flows."

More information: Julien Sauvagnat et al, Are Executives in Short Supply? Evidence from Death Events, *The Review of Economic Studies* (2023). DOI: 10.1093/restud/rdad027

Provided by Bocconi University