

Contractual Externalities and Managerial Turnover

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Abstract

This paper shows that one firm's contracting choices exert an externality on other firms, via its effects on the labour market for managers. If one firm terminates its manager following poor performance, it augments the pool of managers available for hiring to other firms. This in turn increases other firms' incentives to also terminate their manager. As a result there may be multiple equilibria. In one equilibrium managerial turnover is high and managers engage in short-term strategies. In the other equilibrium, turnover is low and managers choose long-term strategies. The paper discusses policy implications of the apparent coordination failure problem.