

Analysis of Management Performance Change of Korean Agricultural Co-operatives around CEO turnover

Hyun-Chang Lee*, Seong-Taek Park**, Kyo-Jik Song***
Nonghyup Sejong Education Center*
MIS, Chungbuk National University**
Global Business Administration, Sungkyunkwan University***

국내농협 경영성과 변화와 최고경영자 교체에 대한 분석

이현창*, 박성택**, 송교직***
농협 세종교육원*, 충북대학교 경영정보학과**, 성균관대학교 글로벌경영학과***

Abstract This paper aims to determine whether the changes in management performance of domestic agricultural cooperatives had an effect on the election results of Korean Agricultural Cooperatives in 2015. Financial performance data (2012-2015) prior to the Nation-wide Cooperatives elections in 2015 were reviewed to determine the impact of the election outcome on the election results. 2SLS Probit regression analysis shows that the significant parameters for incumbent president turnover in the 2015 election were the candidates' age, net profit decrease in 2014, and ROA comparison to similar asset-size group. These results support the conclusion that the union members of KAC consider whether the age of president is over 60, whether the net profits of the cooperatives are worse than the previous year, and compare the results of similar groups' managerial performance (ROA).

Key Words : CEO turnover, Relative performance evaluation, Agricultural cooperatives, Union president election, Corporate governance

요 약 이 논문은 지역농협의 경영성과 변화가 2015년에 실시된 전국조합장선거 결과에 유의한 영향을 미쳤는지에 대해 알아보려 한다. 2015년 최초로 실시된 전국 조합장 선거 이전의 경영성과 데이터 (2012년에서 2015년까지)와 선거결과를 기반으로 2SLS Probit 회귀분석한 결과에 따르면 2015년 재임 중인 조합장 교체에 미치는 유의한 변수들은 후보자 나이, 전년도의 순이익감소 그리고 유사규모의 자산을 가진 그룹의 평균 ROA등 이었다. 국내농협의 조합원들이 조합장의 나이가 60세 이상인지, 순이익 규모가 전년대비 감소하였는지를 비교하면서, 유사한 자산규모를 가진 그룹의 평균 ROA가 높을수록 교체 가능성을 높이는 것으로 보인다.

주제어 : 최고경영자 교체, 경영성과평가, 협동조합, 농협조합장선거, 지배구조

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Corresponding Author: Kyojik Song
(Sungkyunkwan University)
Email: roysong@skku.edu

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1. Introduction

The cooperative combines the profit motive of the cooperative organization for sustainable growth and the pursuit of individual interests, and the pursuit of individual interests among its clients and owners. The U.S. Department of Agriculture (USDA) defines the cooperative as a business entity that owns and controls the benefits to users[1]. The biggest difference between a cooperative and a stock company is whether all members of the governing body have equal management rights (one vote per person, not one stake). A question arises whether the leader of a cooperative, which has a different governance structure from a stock company, is made up of changes in managerial performance, such as in the case of a stock company.

The selection of cooperative managers by cooperative members of cooperative union members is not easy to measure, due to the lack of objective measures such as stock market indicators. Furthermore, the union is not allowed to focus solely on enhancing the financial performance of the union, as the union must focus on fulfilling its social and cultural needs in addition to improving management performance. The local agricultural cooperatives will decide whether to replace the chief executive, who serves a term of four consecutive years, with the union's election. The heads of local agricultural cooperatives carry out core managerial activities as a practical CEO while conducting the plenary sessions, chaired by the General Assembly, the Council of Representatives, and the Board of Directors.

After the expiration of the Government's nomination in late December 1988, a combination of union members decided to resume the current union chairmanship. There was a nationwide election for the first time in 2015, the expectation of the changes being to increase the development of local agricultural cooperatives[2].

This paper is concerned with the change in

management performance and the possibility of changing management performance in the form of the cooperative, which was formed by the presidents reshuffle of KAC in 2015. In order to analyze the components of influence on results of the elections in 2015, various variables were checked based on the regional cooperatives' indigenous characteristics such as net profit change, comparative performance measures, and candidates' characteristics. It was somewhat alleviated by 2015 election that the analysis about KAC president election result had difficulty finding common factors. The stark contrast of this thesis to the existing research is the first attempt to conduct a nation-wide analysis of the president's replacement in the KAC by using the idiosyncratic character of each Co-op.

More specifically, management and financial data variables from 2012 to 2015 and individual characteristics variables are utilized. This paper executes 2SLS probit analysis based on the size of assets, classification of local cooperatives into 32 groups, and average financial parameters for each group as instrumental variables. The 2SLS probit analysis was utilized in order to eliminate the external factors in this analysis.

2. Theoretical backgrounds

2.1 Relative management performance evaluation

Existing studies have estimated that the CEO is evaluated by the relative performance evaluation method. The key rationale in relative management performance evaluation is the comparison of performance to its peers. Holmstrom, Diamond and Verrecchia suggest that performance assessment should be performed on the basis of relative valuation to the external market[3,4,5]. Others, including Hirshleifer and Thakor, Weisbach, Warther, Adams and

Ferreira, Taylor, said the Board of Directors has the ability to evaluate the CEO's ability based on their own management performances and external signals[6,7,8,9,10,11].

M.S. Cichello et al. studied the turnover and promotion cases of employees in companies belonging to the top 25% through 75 % of listed companies based on sales scale, and the division of department managers in the company's department was correlated with ROA (-), and accounting information was used to evaluate the ability to evaluate departmental management capabilities[12]. When deciding to replace the department chief, comparison to departmental performances within the same industry seem relevant, but comparison with other departments' performances do not. However, it turns out that there was a strong correlation whether it can prove better performance than other sectors in the company.

Jenter and Kanaan stated that the efforts of the comparative management evaluation theory have been overlooked for the overall economic cyclical cycle, arguing that it is an efficient move of the Board of Directors not to fire more CEOs during the recession[13]. The representative of the Board of Directors is required to determine more accurate decisions in the CEO selection. It is emphasized that a simple frame workload can not account for many CEO fire cases by the use of simple frame work. More CEOs are fired when they are likely to be under recession because of the fact that one company's management activities have a close influence on one another, such as in an oligopolistic firm. As the Board of Directors is aware of the overall industrial cycle decline, such as in Eisfeldt and Kuhnen, it is often invoked due to the limitations of the Board of Directors which fails to distinguish between the external and corporate performance factors[14]. On the other hand, the cases in which the CEO gets fired even if the company performs well, indicates that the lack of executive ability is likely to be obscure when the overall

industrial cycle is better, which means that the Board of Directors failed to monitor the managerial role of the managerial activity. There is no evidence that the performance within a same industry has less impact on the replacement of the CEO with a longer term., although it turns out that managerial performance during the recession becomes more useful information about the CEO's capabilities. If it is concerned the impact of the recession on the CEO's replacement has to be bigger, the impact of the recession on the replacement for the chief executive of a long term office should be bigger, but the result was the opposite. It turned out that stronger CEOs, such as the company's founder, CEO of a company with a high stake in the company, and the CEO of a company with a high level of compensation compared to other firms, does not have the better position in replacement. They prove that the correlation between Chief Executive replacement and idiosyncratic characteristics of CEO such as the tenure and power of CEO is not significant. In conclusion, they stated that we should be concerned about the fact that the top managers lose their fruits in recession rather than in the boom season, because it is possible to spread the slack of barely escaping the worst performance in the boom season among the top executives, rather than boosting performance in the recession.

2.2 Corporate Governance & performance of KAC

The National Agricultural Cooperative Federation (NACF) has 2.3 million members of the total population of 2.85 million farmers. It is composed of 1,134 local cooperatives as members. The National Agricultural Cooperative Federation and affiliated agencies are comprised of 16 regional headquarters, including 16 regional headquarters and owners of financial and economic projects, and affiliate and agricultural companies such as Farmers Newspaper and Agricultural Cooperatives University, and so on. The

membership requirements of agricultural cooperatives, which form the basis of Nonghyup System Organization, are stipulated in Article 19 of the Agricultural Cooperation Act[2].

The members of the association are agricultural farmers who have an address or a business establishment in the area of the local agricultural cooperatives and are required to invest more than the prerequisite number of stipulated stocks in the articles of association of the respective agricultural cooperatives. The cooperative governance structure, such as in Shleifer and Vishny, can be seen as a reliable arrangement for members of the cooperatives to guarantee dividends to the equity[15]. If the concepts of Zingales et al apply, the cooperative governance structure is also considered to be a framework for controlling interests among stakeholders[16]. The structure of the conflict among managers, shareholders and creditors in the agency costs and ownership structure of Jensen and Meckling may be described as a conflict structure in cooperatives among the membership types of the cooperatives such as the preferred stockholders, common stockholders and business users[17]. The ownership structure which allows the exercise of one vote for each member is to become an important monitoring tool.

According to Cook, the leader of user-owned companies such as cooperatives argued four additional capabilities besides basic entrepreneurial equipment[18]. The leadership ability to utilize human resources rather than financial portfolio capability should be superior to the ability of financial resources. Since the extensive capabilities of the cooperative association, including the ability to deal with ambiguity, complexity, and conflict of interest, are required for cooperative leaders. Communication skills should be excellent for the management of the union members' interests and interests. The ability to promote unity among members of the board of directors has to be encouraged to achieve strategic thinking, consensus and empathy.

Porter and Scully highlighted the governance structures and responsibilities of cooperative associations that result in transaction costs, decision delays, information asymmetry monitoring costs, costs of convergence, and decision making[19]. The vulnerability of cooperative of property rights, such as joint usage and joint ownership, has resulted in cooperative inefficiencies. The inefficiency of the property structure is the same for the cooperative bank. Fonteyne and Win noted that cooperative activities by cooperative members have a weak link to monitoring of cooperative bank activities[20]. They pointed out that there is a possibility of exploiting activity in the background, because there is a lack of pressure to decrease management costs due to lack of forced pressure in the market.

2.3 Management performance of KAC

Williamson stated that "corporate governance" was the process of implementing a contract and resolving conflict between stakeholders[21]. Park et al. said a corporate governance structure was the decision to control the management of executives and businesses in order to achieve their original goals[22].

According to Fonteyne and Win, the cooperative banks may have vulnerable governance structures because the cooperative investor does not have sufficient incentives to monitor bank management[20]. In fact, the cooperative capital is characterized by a long-term contribution that is expected to be invested regularly rather than as a temporary investment in short-term investments. There is even a chance to be inherited. Cooperative members have lower monitoring interest about bank management performances, since they have low ownership of the capital. There is higher risk of pursuing personal progress of top executives, as much as management of executives have recognized the situation. The lack of eviction pressure from the financial market is also likely to contribute to the

continuing lack of managerial efficiencies.

On the contrary, J. B. Kim stated, "In comparison to the commercial bank in Europe from 2003 to 2012, the cooperative banks have stronger information capabilities for customer than commercial banks, and thus, the bank has no significant differences in profitability than banks aiming to maximize profitability." [23] Hirtle claimed that there was no systematic correlation between bank profitability of banks and network sizes. [24]. Kim said, "The higher the portion of the foreign investment, the better the managerial performance of the commercial banks, and eventually the governance structure influences the management performance of the bank." [25].

Local agricultural cooperatives are likely to cause vulnerability in the governance structure of the cooperatives, which is maintained by Fonteyne and Win, which needs to maintain a certain level of margin rate because of dividends for members, and more than 80 percent of the business profits associated with financial transactions [20]. There should be the limit to the unique nature of the cooperative capital of the cooperative such as the relatively small amount but long-term and single voting right per each shareholder.

3. Hypothesis and research method

3.1 Establishment of research hypothesis

In this study, the followings assumptions are made to analyze the change in management performance according to the replacement of the president of cooperatives, considering the uniqueness of the governing body of the cooperative. In general, the top executive change is concerned as an important event in management performance, and if the replacement of them is a shift, the improvements of performance are made if the replacement is coercive rather than voluntary. Denis and Denis demonstrated that performance was improved after replacement of the

CEO, as a result of investigation about the enforced substitute cases of 353 CEOs owing to deteriorating management performance from 1985 to 1988 [26]. They did not find that managerial performance deteriorated before the CEO's voluntary replacement was achieved and managed marginally improved management performance after voluntary replacement. The electoral substitution of the local agricultural cooperatives, which are elected by cooperative members, is equivalent to a coercive replacement, such as the study of Denis and Denis [26]. In this regard, we intend to investigate the significance of the worsening of the management and electoral changes of the local agricultural cooperatives.

Hypothesis 1. In local agricultural cooperatives, where the president of cooperatives were replaced, the management performance would have deteriorated before electoral changes of the local agricultural cooperatives.

As Cook discussed, the leaders of the company, such as the cooperative unions, are responsible for the combination of union rights, human rights management, and unity of the cooperative membership, in addition to management performance development [18]. Due to the cooperative nature of the cooperative union, it is somewhat too much to establish managerial ability as the sole criterion for selecting the union presidents. The following assumptions were established for the individual characteristics of the winners as a result of the 1st nation-wide election of local cooperatives in March 2015.

Hypothesis 2. Individual attributes, such as educational background and age, will have a significant impact on the possibility of replacing the president of local cooperatives.

Jenter and Kanaan assert that the analysis of the

firm's business should include descriptions of the overall business and segment performances of the industry regarding the comparative management performance of the existing CEO's replacement[13]. Despite a great deal of effort in the relatively competitive management, evaluation efforts have been neglected for the overall economic cycle, it is not the property of the Board of Directors to dismiss more CEOs in the recession than in the economy. To make more accurate assumptions about what replaces CEOs, it is important to note that when evaluating the CEO, the external impact of the measurement must be filtered out. For the purpose of discovering the cause of the result, we try to analyze the possibility of electoral replacement by separating the unique characteristics of each cooperative and the average characteristics of the each group, which is based on variables such as ROE, ROA, and the net income change of the Agricultural Cooperatives.

Hypothesis 3. The average performance of similar asset sizes-group will have a significant impact on the possibility of replacing the union heads since the asset size reflects the management performance of similar groups in election.

3.2 Overview of samples

Only 351 of the 560 incumbent president candidates of local cooperatives were left in victory as the result of election on March 11, 2015. In this paper, we refer to the nation-wide election results of agricultural cooperatives in Seoul, Kyonggi Province, Gwangju, Ulsan, Daegu, Incheon, Daejeon, South Chungcheong Province, and Busan. See how variables such as ROE, ROA, and the net income change and academic background of candidates and age of candidates, affect the continuation of the result of the election. This research material was collected by the Financial Statistics Information System and utilized the management performance analysis. Ultimately, we tried

to find which factors significantly affected the president's replacement.

Under Article 83 of the Credit Cooperatives Act and Article 32 of the Enforcement Regulations of the Financial Services Industry Act, Article 32 of the Financial Services Commission Act, the management information of the cooperatives is provided quarterly within a month after quarterly settlement to enhance the convenience of financial statistics users[2].

From the 2015 election data of Seoul, Gyeonggi Province, Gwangju, Ulsan, Daegu, Incheon, Daejeon, South Chungcheong Province and Busan, Chungnam Province, and Busan, we analyze the relationship between the financial performance change from 2012 to 2015 and the probability of leadership replacement in 2015 based on financial variables such as ROE, ROA, and Assets, and the age of association and academic background, the results of which are shown in <Table 1>.

The local agricultural cooperatives, which replaced the leader, are better educated than their counterparts, and the average age in replacement cases is four years younger than the median of 62 years in the non-replacement group.

<Table 1> Samples descriptives

	turnover			remain		
	n	avg.	median	n	avg.	median
academic ability	181	2.80	3.0	164	2.56	2.50
age	181	58.27	58	164	62.05	62

Looking at the status of financial performance (ROE, ROA, asset size) on a time-series basis from 2012 to 2015 in <Table 2>, asset sizes are growing, while profitability indicators such as ROE and ROA are deteriorating. There seems to be no significant difference between the turnover cases and remaining cases in terms of financial performance. Overall, the average financial performances of local cooperatives are worsening. Considering the fact that the

loan-and-deposit dependant ratio of the cooperatives has reached 85 % under the decline in interest rates for many years, the worsening of the situation is explained.

<Table 2> Ffinancial Performance change 4 years before CEO election

		CEO Change		
var.	year	n.	avg.	median
ROE (%)	2012	181	6.80	7.04
	2013	181	4.91	5.65
	2014	181	5.30	5.29
	2015	181	4.86	5.00
ROA (%)	2012	181	0.53	0.52
	2013	181	0.41	0.43
	2014	181	0.44	0.42
	2015	181	0.39	0.38
Total Asset (Million wons)	2012	181	309,378	170,750
	2013	181	316,468	176,163
	2014	181	331,999	188,151
	2015	181	350,783	208,194

		CEO Remain		
var.	year	n.	avg.	median
ROE (%)	2012	164	6.87	7.00
	2013	164	5.11	5.50
	2014	164	5.29	5.42
	2015	164	4.56	4.98
ROA (%)	2012	164	0.52	0.50
	2013	164	0.41	0.42
	2014	164	0.41	0.41
	2015	164	0.36	0.38
Total Asset (Million wons)	2012	164	368,781	225,403
	2013	164	379,489	235,785
	2014	164	401,735	255,635
	2015	164	422,914	270,811

(Source : <http://fisis.fss.or.kr/fss/fsi/id/fssview01.jsp>)

4. Verification and result

Jenter and Kanaan used the same group performance as instrumental variables to derive the CEO's capability to estimate the probability of a firm's CEO's shift[13].

When applying their methodology to the thesis, we regard the leader of cooperatives replacement by the election as enforced turnover, and check whether voters worry about the management performance of the

agricultural cooperatives with similar assets or capital scale. We used the average performance of the similar asset-sized group as instrumental variables to derive the CEO's capability to estimate the probability of the cooperatives' president's replacement by using 2-stage least squares (2SLS) regression.

Through this process, we consider whether the voters consider the management performance of the peer group with similar assets or capital, or they only reflect the unique management performance of individual unions with using metrics such as changes in net income, changes in net profit margins, ROA, ROE, etc. Assuming that the performance of the peer group is an exogenous variable, the impact of the change of peer group should be insignificant for the result of election.

The regression model for this analysis is as follows.

$$First\ stage : r_{i,t-1} = \beta_0 + \beta_1 \cdot r_{peer\ group,t-1} + v_{i,t-1}$$

$$Second\ stage : CEOchange_{i,t} = r_0 + r_1 \cdot \hat{r}_{i,t-1} + r_2 \cdot \hat{v}_{i,t-1} + s_{i,t}$$

" $\hat{r}_{i,t-1}$ " in the first stage of the regression formula represents the performance of peer groups unrelated to the leader's activities or abilities, and " $\hat{v}_{i,t-1}$ " is a unique achievement of the respective cooperative. It is assumed that the performance of a homogeneous group should be an external variable, such as a luck-down of a leader, and that it should be thrown into the same way as a leader, and that the outcome should not affect the president's turnover. On the other hand, " r_2 " is an idiosyncratic factor affecting the performance of the local agricultural cooperative. It seems to have a negative relationship with enforced turnover. In fact, " r_1 " should be closer to "0" and " r_2 " should be negative.

<Table 3> Significant influential factors on 2015 election

	Second-stage Probit regression	
	CEO change (p-value)	
	Model 1	Model 2
Constant	0.49(p<.0001)	0.75(p<.0001)
each_ROA_2014	-0.01(0.93)	
asset class_ ROA_2014	0.67(p<.0001)	
each_ROA_2015	0.19(0.18)	
asset class_ ROA_2015	-0.39(-1.17)	
each_ROE_2014		0.005(0.52)
asset class_ROE_2014		-0.01(0.43)
each_ROE_2015		0.008(0.51)
asset class_ ROE_2015		-0.00(0.98)
CEO_age_dummy (over 60)	-0.28(p<.0001)	-0.29(p<.0001)
CEO_academic ability_dummy (above high school)	0.09(0.10)	0.07(0.17)
Worse than last year_dummy	-0.13(p<0.01)	-0.13(p<0.01)

Model 1 in Table 3 is the 2SLS regression analysis result with a dummy variable that takes a value of “1” if there is a president change and “0” otherwise. The report is a 2SLS regression analysis result of the financial performance and the idiosyncratic characteristics of elected presidents. The independent variables for financial performance are average ROA of the similar asset sized group, and whether net income has deteriorated over the previous year. For convenience purposes we only report second - stage probit results. The dummy variables in use for individual characteristics of the elected presidents were “their age is 60 years or less”, and “their academic background is above high school graduation or not” Model 2 uses return on equity (ROE) instead of ROA.

First of all, results showed that ROA did not affect the outcome of the election. On the other hand, the higher the average ROA in a similar asset-sized group in the previous year, the higher the possibility of current president turnover. This indicates that voters are evaluating the ability of the existing leader by

referring to the profitability (ROA) of similar asset scale entities. Model 2 shows that ROE, even ROE of similar asset-sized groups, is not related to the result of the election.

Both Model 1 and Model 2 shows there is a significant impact on the possibility of replacement when the presidents’ age is under age 60 and it appears that the dummy variables, indicating whether net profit has increased compared to 2013 in 2014, have significance for replacing the union heads. In other words, the possibility of turnover increases when the president of cooperatives is younger than 60, and the possibility of turnover decreases when the current year’s net profit becomes worse than the previous year.

The implications for the analysis results can be summarized in several ways.

First of all, the 2015 election results show that the characteristics of the chief executive of the local agricultural cooperatives are based on local communities because presidents under 60 years old have a significant correlation with turnover in 2015 election. As Cook argued, the cooperatives is a type of user-owned company, and have difficulties in CEO selection[18]. Their criteria for selecting the best executives of the company are difficult to decide by only considering the performance capability of the leaders because the cooperative presidents are elected by neighborhood residents who have been in long-term relationships among them with common backgrounds like a school ties, regionalism, etc. The result that the chances of being elected become higher when the age of candidates is older than 60 years old, is more likely to reflect the long-standing network characteristics that have been established based on the community.

Second, the fact that the deterioration of the management performance against previous year indicated a significant impact on the probability of replacing the presidents of local agricultural cooperatives, means that the degradation of the managerial performance was preceded before turnover.

According to Denis and Denis, the management performance improved after the board of directors replaced the CEO with poor performance, which means the degradation of the managerial performance was preceded before turnover like our result[26].

Third, using the comparative management and evaluation methodology of Jenter and Kannaan, we examined whether the peer group's performance reflected a significant impact on the change of regional cooperatives[13]. The turnover possibilities of incumbent presidents become higher both in terms of annual net profit deterioration in the year prior to the election and in the case of ROA under-performance to a similar asset-sized group. This means that voters were taking part in the 2015 election taking into account their peers' performances and their respective management performances.

5. Conclusion

According to Article 1 (1) of the Agricultural Cooperative Federation Act, the agricultural cooperatives aim to improve the economic, social and cultural status of farmers by improving agricultural,[4] social and cultural status, and improving the quality of the farmers' lives through enhanced agricultural competitiveness. In order to achieve the unique purpose of the local agricultural cooperatives, the chief executive of Nonghyup, is faced with the double-task of sharpening the competitiveness of Nonghyup and meeting the economic, social and cultural needs of the union at the same time.

This analysis of changes in managerial performance of Co-ops, such as those seeking to improve the social welfare status of corporations, while competing with corporations seeking to improve their social welfare status, is a testament to the difference in the performance of the company's top executives, including the incumbent corporation.

Jenter and Kannan noted whether the Board of Directors can distinguish between the performance of the company with its unique factors and the average outcome of the similar asset size group, such as the performance of the company's peer group[15]. This study endeavored to define whether the comparative differences between average performances of similar assets-size group and ones of the respective Cooperative had affected the KACs election results. The 2SLS probit analysis was utilized in order to eliminate the external factors in this analysis. This paper executes 2SLS probit analysis based on the size of assets, classification of local cooperatives into 32 groups, and average financial parameters for each group as instrumental variables. According to the results verified by 2SLS Probit Regression Analysis, significant parameters influencing the 2015 election result are whether "union presidents candidates' age were over 60" and whether "net profit decreased in 2014 compared to last year's full-year net profit" and whether "the average ROA of similar asset size group is higher than respective cooperative". These results showed that Cooperative members determined the financial performance, such as net profit and ROA, as touchstones by comparing them with ones of the similar group, at the same time checking whether Co-ops presidents are over 60 years old or not. In contrast to the existing research, the main contribution of this thesis is the first attempt to conduct a nation-wide analysis of the president's replacement in the KAC by using the idiosyncratic character of each Co-op. Although there was a significant effect despite the limitations of the country's inability to adapt to small cities nationwide, it seems to be possible to see the impact of each president's turnover in the 2015 election, whether he is improving each co-op's respective management performances.

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이 현 창(Lee, Hyun Chang)



- 2001년 2월 : 건국대학교 무역학과 (상학사)
- 2010년 12월 : KDI국제정책대학원 (자산운용경영학석사, 정책학석사)
- 2017년 2월 : 성균관대학교경영대학원(경영학박사)
- 2016년 2월 ~ 현재 : 농협 세종교육원 교수

- 2017년 3월 ~ 현재 : 농협대학교 교수
- 관심분야 : 기업지배구조, 협동조합
- E-Mail : jjason1@naver.com

박 성 택(Park, Seong Taek)



- 2003년 8월 : 충북대학교 경영대학원(경영학석사)
- 2010년 2월 : 충북대학교 경영정보학과(경영학박사)
- 2011년 7월 ~ 2012년 6월 : 성균관대학교 경영연구소 박사후연구원
- 2014년 6월 ~ 현재 : KASOM 빅데이터 전임교수

- 관심분야 : 빅데이터 분석, 텍스트마이닝, 특허가치평가, 특허경영, 공급망관리 등
- E-Mail : solpherd@cbnu.ac.kr

송 교 직(Song, Kyojik)



- 1993년 2월 : 연세대학교 사회학(BA)
- 1999년 8월 : Iowa State University(MBA)
- 2003년 12월 : Louisiana State University(경영학 박사)
- 2003년 8월 ~ 2006년 5월 : University of Louisiana 교수

- 2006년 9월 ~ 현재 : 성균관대학교 글로벌경영학과 교수
- 관심분야 : 기업재무
- E-Mail : roysong@skku.edu