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THE IMPACT OF CFOS MANAGERIAL CHARACTERISTICS ON CAPITAL STRUCTURE DECISION AND FIRM PERFORMANCE: A CONCEPTUAL STUDY

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ABSTRACT

This paper explore the impact of Chief Financial Officers (CFOs) managerial characteristics on capital structure decision and firm performance. Factors such as company risk, tax exposure of the company and financial flexibility are the traditional factors which were researched extensively in this research area. Hence, this paper will seek to show managerial characteristics as an equally important elements in determining the capital structure and the firm performance. The study is of particular important since developments in the study of finance have shown that the financial decisions are being influenced by managers-shareholders conflict. By drawing from a vast body of research, the study will make a solid concept as well as provide a comprehensive understanding about how CFOs managerial characteristics, such as age, level of education, tenure, and functional track, influence capital structure decision and firm performance.

KEYWORDS: Chief Financial Officer (CFO), managerial characteristics, capital structure decision, firm performance, age, level of education, tenure, and functional track

INTRODUCTION

The capital structure decision is one of the most crucial aspects of managing a company since one of the tasks of the management of an organization is to increase the firm value. A growing company will usually need capital which can be financed by a mix of debt and equity

(Al-Matari, Al-Swidi, & Fadzil, 2012). The job of the financial manager will be to find the optimal combination of funding that increases the value of the shareholders (Mak & Li, 2001). The differences in the variety of capital structure decisions in the market provide a valuable insight into the factors that influence such decisions. Managerial traits such as age, education level, and tenure of leadership are some of such important qualities (Peni, 2014). Managers with growth perception bias will likely overestimate the future earnings and will view external finance as unduly costly while managers with risk perception bias will likely seek external finance since they perceive the equity of the firm to be overvalued (Harkbarth, 2008).

While the traditional approach states that financial managers act in the interests of the shareholder, it is important to note that in modern times some financial decisions are influenced by manager-shareholder agency conflicts (Johl, Kaur, & Cooper, 2015). Such knowledge means that managerial characteristics play a role in determining the capital structure of the company. While some executives are very influential, others are relatively subdued in the conduct of their business (Harkbarth, 2008). Some executives and their successes of activities could be well known in the market and by the public in Colombo leading to an increase in the value of the firm once they are at the helm (Peni, 2014). By drawing from a variety of academic studies, it can be shown that managerial characteristics have a significant impact on the capital structure and the performance of the firm.

REVIEW OF LITERATURE

The human resource refers to the full range of skills, abilities, and knowledge a person can exploit to produce the set outcome. Auw (2009) describe human capital as consisting of skills, experience, and education at a given point in time. As noted by Memon, Mangi, & Rohra (2009), the human factor has, for decades, been ignored as a critical factor that determines company performance regarding the influence it has on capital structure decisions. Several previous studies hold the claim that the human capital factor should be put into consideration while evaluating an organization's strategy. Boxall (1996) stated that the fundamental priority of any human resource strategy lies in securing and maintaining the organization's human resource to sustain the company's viability. With this consideration, it becomes prudent to understand that managerial behavior has an impact on capital structure decision and firm performance. While firms may have relevant human capital, they, often, do not put into consideration the strategic impact of managers with regards to their capital management and designing of work.

If human capital refers to the skills and knowledge embodied in an individual, then managerial characteristics could as well be viewed as a specialized form of human capital concerning product organization and capital structure decisions while affecting firm performance. Liu & Ravichandran (2007) hold the view that managerial characteristics such as age, experience, and education can help to predict the strategic outcome of finance-related decisions. In a related study, Ben-David, Graham & Harvey (2007) considered managerial overconfidence in making future forecasts about financial decisions. They discovered that firms with overconfident CFOs have less flexible capital structure. Specifically, debt leverage and the proportion of long-term debt to total debt was higher in firms with overconfident CFOs. Ben-David, Graham & Harvey (2007) explain the various methods in which the features of a CFO might affect the performance of the firm through the chosen form of capital structure.

Radell (1997) did a study on employee turnover within the management and discovered that it affected company gets deprived of necessary skills and experience to optimize capital growth. It is through continuous capital structure decisions that managers learn the best way to make use of available capital regarding organizing and executing commissioned work. Gupta & Govindarajan (1984) argued on the need to link managerial characteristics with job requirements by way of drawing a line on the significance of strategic decisions in an organization. Patterson et al. (1997) conducted a study on human resource and capital usage and concluded that managerial characteristics have a strong effect on a firm's performance, especially, when such a case is measured with regards to productivity or profitability.

Managers represent the unique organizational structure, and their character is directly reflected in the shape of the organization's strategic choice. Liu & Ravichandran (2007) goes further to state that managers play a significant role in the strategic organization of any business which translates to the general profitability as far as capital structure decision is concerned. Simonova, Bruna, & Ilmete (2011) argue that the concept of human capital as used in the context of public management necessitates the understanding of financial capital and quality input of managers to an effective output in the organization. To have efficient capital structures and significant profitability, managerial characteristics need to reflect a high level of dedication to delivering high-quality services to customer's satisfaction. The manager in a public sector like listed companies at the Colombo stock exchange need a clear cut combination of their personal qualities, the strength of character and operate in a well suitable environment to be able to come up with the right capital structure decisions and, hence, improves the firm's performance.

Demmke (2010) explains further that when there is the development of character strength among managers, integrity and accountability become the foundations upon which the company increases its share capital and expands its shareholding capacity in the market. Although there is the underlined significance of managerial characteristics to capital structure decisions, it is critically significant to highlight that training of the managers has an impact on their evaluation of conduct in business. What this means is that, as McCarthy, Grady, & Dooley (2011) put it, their involvement in strategic planning processes vary depending on their individual managerial characteristics. McCarthy, Grady, & Dooley (2011) indicate that effective leadership is a key element in good administration and mobilization of capital. Managerial characteristics are enablers of change and, therefore, there is the need to strengthen managerial capabilities to ensure better capital structure decisions and firm performance.

Managers who operate in an environment that is divergent with competing priorities need to have a firm grasp of effective policing strategies to produce civic-oriented results to the benefit of the company and end-users of services or goods delivered by the company. McCarthy, Grady, & Dooley (2011) emphasize that in the wake of globalization, leaders need to reshape their service leadership which begins with their personal characteristics as managers. The defining components of such a domain are that managers need to know themselves, embrace higher stress tolerance levels, practice clear critical thinking, tend to accountability, and demonstrate personal energy and passion towards achieving results. Consumers reform to managerial cultural changes which directly have an impact on the firm's performance. Therefore, there is a significant correlation between managerial characteristics and capital structure decisions that have an impact on firm's performance.

Sebaa, Wallace, & Cornelius (2009) maintains that the alignment of several demographic factors with strategic orientations improves performance resulting in better usage of available capital. Analoui, Moghimi, & Khanifar (2009) concludes that the decision to act entrepreneurially depends on interactions among individual characteristics as exemplified by a manager in a company. McCarthy, Grady, & Dooley (2011) conducted a study on the impact of human capital variables like age, gender, and education, and found that there were no significant differences in leadership domains across these variables. However, the number of years a manager has been in the senior leadership position was influential regarding his/her long experience. As for the competence level, he found that managers in the mid-level age bracket exhibited the highest score for competence. Also, managers with high education levels were more concerned with personal technical proficiency and developing their skills to meet the changing business environment.

HYPOTHESIS DEVELOPMENT

Based on the above, and depending on the analysis of companies listed on the Colombo stock exchange. Following managerial characteristics will be tested.

Age: it is expected to become an issue through the manager's way of working, dealings with his/her employees, behaviors with unprecedented situations, risk acceptance as reflected by uptake of new opportunities as well as openness to new ideas, and other primary factors that may be affected by the age of the manager. Age of manager is expected to have an influence on capital structure decisions given the change in financing perspectives with age. Moreover, there is a significant decrease in flexibility and resistance to change as people increase in age. The business community attests to the fact that security becomes primary as people age as it will be evidenced by managerial practices executed by managers in that age bracket. They tend to avoid risky investments, especially, the ones necessitating significant strategic change within the organization.

On the other hand, young managers have a high-risk appetite. Also, older managers exhibit less confidence in the execution of their decisions and, thus, may lack the required conviction for providing managerial leadership for strategic change. This, by extension, affects the firm's performance regarding capital returns due to limited platforms of investment. Furthermore, the age variable is a good indicator of a person's non-work-related experiences. Individuals in the same age group have similar experiences and, therefore, share beliefs and attitudes regarding the different ways of exercising one's managerial duties and responsibilities. In the same context, Taylor (1975) indicates that old managers are less superficial information processors and decision makers. Lee, Yen, & Chen (2008) think that age impacts managerial characteristics and could diminish the manager's capacity to cope with the job of managing an organization. Thus, I propose the following:

H1a: Age of the manager has a significant impact on firm performance and capital structure decisions.

Level of Education

It is prudent to say that the level of education is directly proportional to the receptivity of innovation, where that, the more educated managers have greater psychological complexity, thus, the high absorption rate for new ideas and increased acceptance to innovations. Also, education level is the reference for evaluating cognitive skills even as people tend to positively associate education with learning-by-doing performance. The level of education reflects a manager's skills and his/her cognitive abilities, hence, in that same token, high education levels are affiliated to a high capability to processing critical organizational information. Managers with a high level of education tend to tolerate ambiguity and high capacity for integrative complexity.

In addition to this, Wiersema & Bantel (1992) showed there exists a relationship between the level of education and receptivity to innovation. As noted by Ahn, Mortara, & Minshall (2014), a high level of CFO's education can be a measure of the initial human capital to an organization. Therefore, it can have a significant strategic impact on the organization's capital structure and performance. High information processing ability enables a person to overcome the effects of information overload together with analyzing complex knowledge that is appropriate to capital structure decision-making. Hatch & Dyer (2004) on commenting on human capital selection state that, managerial development through training enhances learning and its subsequent deployment improves firm performance. Thus, I propose the following:

H1b: Level of education has a significant positive impact on capital structure decisions and firm performance.

Tenure

managerial tenures reflect a time-based process of understanding the external and internal environment of an organization. Therefore, a longer tenure yields more knowledge regarding a particular job and the context of organizational structures, including capital structures. Also, an increase in the manger's tenure has a direct proportionality with the level of influence the manager has in the organization regarding policies implementation. They tend to run the organization in their pattern that is in line with their behavioral convictions (Liu & Ravichandran, 2007). Simsek (2007) explained that short-tenure managers lack sufficient awareness while evaluating strategic risks. Also, they are not prominent in the business community, lack legitimacy, and are untested in the most turbulent times, hence, are limited in consistent performance.

On the contrary, seasoned managers have attained deep knowledge of the company's environment, have a performance track record and relevant job skills. A long tenure to a manager, therefore, reflects the extent to which a CFO has been integrated into the business networks of major stakeholders and establishes the capital resources and collaborations that enable the CFO to evaluate, nurture, organize, coordinate, and invest in risky initiatives. Therefore, the CFO has an indirect influence on firm performance through a direct influence on the top management with regards to their risk-taking tendencies and the firm's pursuit of organizational initiatives. Umukoro (2009) indicates that long-tenure managers have great social cohesion resulting from a better understanding of organizational policies and procedural measures. Scott (2010) attempted to show that long tenure mangers have a great likelihood to risk aversion as they get committed to their long-tested models and become reluctant to take up change.

H1c: Manager's tenure has a significant impact on capital structure decisions and firm performance.

Functional track

It influences the managerial duties concerning execution of his/her organizational responsibility. The manager's perspective in light of his/her experience tends to overemphasize on specific company details that tend to get reflected on the organization's performance and capital structure decision. Lee, Yen, & Chen (2008) note that an increase in managerial longevity tends to improve the ability of the manager in providing superiors performance. They not only accumulate knowledge about organizational management but also acquire necessary skills to coping with the ever-changing environment.

Scott (2010) affirms that the functional track has a direct influence on the form of strategic leadership practiced by top managers. An analysis of the strategic role of manager's functional track makes it easy to differentiate performance based on the time spent at different managerial levels. Ahn, Mortara, & Minshall (2014) believe that functional areas help in the identification of managerial problems, especially, in innovation. Essentially, it means that having different cognitive perspectives to ways of information collection and interpretation contributes to strategic and organizational changes. Thus, I propose the following:

H1d: Functional track of a manager has a significant impact on capital structure decisions.

H2: Managerial Characteristics has a significant impact on firm performance with mediating effect of capital structure decision.

H3: Managerial Characteristics has a significant impact on firm performance

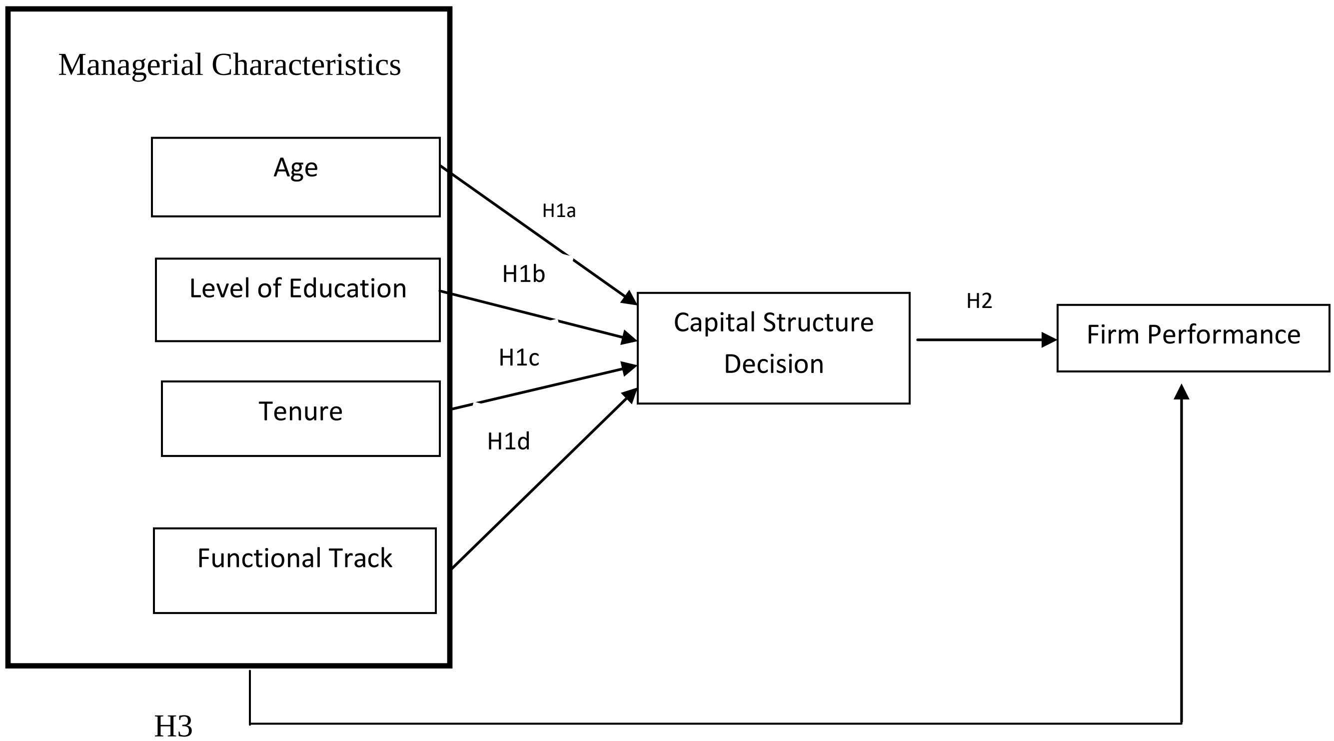

Figure 1: Conceptual Model

DISCUSSION

The primary objective of this study was to examine the impact of the CFOs managerial characteristics on capital structure decision and the firm performance. More specifically, the characteristics considered were age, level of education, tenure, and functional track. It is expected that the managers with older age are likely to avoid debt and opt for equity financing while those in their junior years are likely to go for debt financing in raising capital for the firm. Another trait considered was the level of education of the manager. Highly-educated managers tend to deploy complex strategies in managerial finance that directly affects the capital structure and firm performance. Also, the conceptual study looks into the tenure of the manager which has an impact on the managerial experience. Experience is a unique factor that influences any decision made by a manager in an organization. Finally, the functional track reflects on the performance of the manager regarding the execution of their duties at different managerial levels. A look at all these factors is intended to give a clear picture to some of the managerial characteristics that have a significant impact on capital structure decision and firm performance, especially, at the listed companies in Stock Exchange.

CONCLUSION

The study concludes that managerial characteristics are an important factor in determining the capital structure and performance of the firm. Specifically, age, tenure, functional track and level of education are important factors that affect influence capital structure decision and firm performance. A company should then be careful about the managerial traits to gain the benefits associated with a good team. The study, though done on listed companies at the stock exchange, is, also, applicable to bureaucratic organizations. This should be focused on the administrative side of it more than the technical side. Meaning that, making certain organization's decisions also has an influence on managerial characteristics, hence, indirectly affects capital structure decisions and firm performance. On the broader perspective, this study contributes to the identification of impacts of managerial characteristics on organizational performance, but its significance in corporate governance and growth of a company's profitability cannot be understated. To improve managerial work, there is need to put into consideration the skills, capabilities, and expertise that the manager possesses. The lack of such administrative capabilities negatively influences financial decision making, correction of deviations, and obstructs the smooth flow of work within a company. All these factors, together with the ones under study, play a part in the cumulative success of any organization.

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