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Managerial attitudes and corporate actions ☆

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ABSTRACT

We administer psychometric tests to senior executives to obtain evidence on their underlying psychological traits and attitudes. We find US CEOs differ significantly from non-US CEOs in terms of their underlying attitudes. In addition, we find that CEOs are significantly more optimistic and risk-tolerant than the lay population. We provide evidence that CEOs' behavioral traits such as optimism and managerial risk-aversion are related to corporate financial policies. Further, we provide new empirical evidence that CEO traits such as risk-aversion and time preference are related to their compensation.
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1. Introduction

What causes firms to behave the way they do? The answers to this important question are not well understood. Traditional economic theory suggests companies should simply pursue positive net present value projects to maximize shareholder wealth. However, firms around the globe seem to behave differently, leading some to speculate that heterogeneous objective functions are being maximized (see, e.g., Allen, 2005). Even within the US, firms in the same industry, of similar size and facing similar investment opportunities behave differently.

To what extent do personality characteristics vary among US managers and non-US firms? What is the importance of individual heterogeneity in corporations? The idea that individual heterogeneity matters in corporate finance/governance has recently become a primary

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focus in behavioral finance. Recent papers suggest that managers matter—there are findings on managerial fixed effects (Bertrand and Schoar, 2003); on managerial overconfidence proxies relating to firm behavior (Malmendier and Tate, 2005, 2008); and on Chief Executive Officer (CEO) characteristics in private equity firms being related to outcome success (Kaplan, Klebanov, and Sorensen, 2012).

We use a survey-based approach to provide new insight into the people and processes behind corporate decisions. This method allows us to address issues that traditional empirical work based on large archival data sources cannot. For example, we are able to administer psychometric personality tests, gauge risk-aversion, and measure other behavioral phenomena. Our mode of inquiry is similar to those of experimental economists (who often administer gambling experiments) and psychologists (who administer psychometric tests). As far as we are aware, no other study attempts to measure attitudes of senior management directly through personality tests to distinguish CEOs from others and U.S top level executives from non-US top level executives. We also relate CEO attributes to firm-level policies.

Our survey quantifies behavioral traits of senior executives and also harvests information related to career paths, education, and demographics. We ask these same questions of chief executives and chief financial officers, among public and private firms, and in both the US and overseas. We can thus compare traits and attitudes for US and non-US CEOs to see if there is indeed a significant difference in attitudes. We also ask questions related to standard corporate finance decisions such as leverage policy, debt maturity, and acquisition activity. This allows us to relate attitudes and managerial attributes to corporate actions. We also examine how managerial attributes such as risk-aversion and time preference relate to compensation at the firm level.

We use the survey responses to address the following broad questions. How do US CEOs differ from lay people, and also how do they differ from Chief Financial Officers (CFOs) and non-US CEOs in terms of behavioral and other characteristics? Are managerial psychological traits, career experiences, or education correlated with corporate decision-making? Do behavioral traits such as risk-aversion and time preference explain compensation packages (e.g., is risk-aversion related to lower pay-performance sensitivity as predicted by theory)?

We compare CEOs to CFOs and others in terms of personality traits and career characteristics, as well as make attitude comparisons of CEOs to established norms in the psychology literature. We find that CEOs are much more risk-tolerant than the lay population of similar age profile (studied in Barsky, Kimball, Juster, and Sharpio, 1997). It is notable that CEOs are also much more optimistic than the lay population as compared to the norms in the psychology literature (Scheier, Carver, and Bridges, 1994). We find, as might be expected, that CEOs and CFOs have different personal characteristics and career paths. Interestingly, we also find significant differences between CEOs and CFOs in terms of attitudes. In particular, our psychometric tests suggest that CEOs are much more optimistic than CFOs. Our results also suggest that US-based CEOs and CFOs are more optimistic than their non-US counterparts. This provides evidence on one channel through which US and non-US firms differ: their executives differ in terms of attitudes and traits, perhaps a reflection of firms outside the US having different norms or maximizing different objective functions (Allen, 2005).

Our paper focuses on CEOs because they are the principal corporate decision-makers. In particular, we focus on two key areas that CEOs feel they have the most influence on: mergers and acquisitions (M&A) and capital structure (see Graham, Harvey, and Puri, 2012). We investigate which factors and experiences (e.g., personality traits or career path) of the decision-maker (CEO) affect capital structure and acquisition decisions. We show that these corporate policies are significantly related to the personality traits of executives. For example, we find that companies initiate more mergers and acquisitions when their chief executive is more risk-tolerant. Beyond risk tolerance, one might expect that the level of a chief executive's optimism might be related to the corporate decisions her company makes. For example, optimistic CEOs might expect that recent profitability will continue into the future, or that the future will be better than the recent past. Consistent with this view and the arguments of Landier and Thesmar (2009), we find evidence that optimistic CEOs use more short-term debt than do firms led by less optimistic CEOs. There is also a growing literature that suggests that males tend to be more overconfident than females (see, e.g., Barber and Odean, 2001). Correspondingly, we find that male CEOs are more likely to have higher debt ratios, and in particular, higher short-term debt ratios than their female counterparts.

We find that firms with high historical or future rates of growth are more likely to be run by risk-tolerant CEOs. These chief executives are likely to be younger. They are also more likely to be taller than average. To the extent that height corresponds to confidence (as suggested elsewhere; see, e.g., Persicao, Postlewaite, and Silverman (2004) and Deaton and Arora (2009)), these results are consistent with more confident, more risk-tolerant, younger CEOs being more likely to run growth companies.

We cannot determine the direction of causality between corporate growth and executive personality. Managers may self-select into companies (or companies may hire managers) who have the "right" personality traits for the particular company. What we document is that there is a significant relationship between CEO characteristics and company characteristics.

We also examine the CEOs' target compensation in terms of the proportion due to fixed salary, and separately, the part that is performance-dependent, i.e., bonus, stock, and options. We find that risk-averse CEOs are significantly more likely to be compensated by salary and less likely to be compensated with performance-related packages. We further find that CEOs who are impatient (i.e., have a high rate of time preference) are more likely to be paid proportionately more in salary. These results are intuitive. Standard agency theory, including both

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