Managing with Style: The Effect of Mangaers on Firm Policies

Bertrand, M., & Schoar, A. (2003). The Quarterly Journal of Economics, 118(4), 1169-1208.

Summarised by Shuhei Kainuma on September 24, 2020

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1. Summary

- **Motivation**: In business, it is frequently stated that top executives or managers do make a difference in firm's decision making process and resulting its performance. Yet, little empirical evidence exists. This paper attempts at filling the gap by quantifying the managers' contribution to firm policies and performance.
- **Question**: *Do individual managers matter for corporate behaviour and performance?*
  - Manger: top executives in firms (e.g. CEO, CFO)
- **Data**: A manager-firm matched panel data set to track the top managers across firms over time
  - US firms between 1969 to 1999 with some retriction (e.g. executive transition)
- **Methodology and Finding**: *manager fixed effects* (FE) approach to see...
  - Q. Whether manager FE can explain the variations in the firm policies and performance by checking the adjusted R^2?
    - A. Manager FE seem important determinants of corporate variables, with heterogeneity depending on domains of corporate practices;
  - Q. Whether there are patterns of management *style* by checking the correlation across the manager FE on different firm policy variables?
    - A. There are some systematic patterns of manager FE across different corporate variables, suggesting the presence of varing management style;
  - Q. Whether the management style has efficiency implication by looking at the correlational patterns between manager FE in firm performance and in firm practices, managers' compensation, firm governance?
    - A. Observe some patterns of correlation between manager FE in performance and in corporate practices. Also, managers with high performance FE receive higher salary and compensation. Lastly, these managers are more likely to be in the better governed firms;
  - Q. Whether some managers' observed characteristics systematically relates to corporate practices?
    - A. birth cohort and MBA graduation are related to some corporate policies

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2. Motivation

- A dominant view in the empirical literature of corporate decisions: a *neoclassical* view of firms
  - Top managers are homogeneous and selfless inputs in production
  - Other may assume that top managers do not matter for firm policies

        - Two firms would make similar choices if technologies, factor, and market conditions are quite similar
- Standard agency model: managers may exercise discretion inside their firms to alter corporate decisions for their own objectives
    - Variations in corporate behaviour should be due to heterogeneity in firms' ability to control managers (governance mechanisms)
- Models that allow managers' heterogeneity in their preferences and ability
    1. Agency models in which a manager can impose their own style on a firm if corporate control is poor or limited
    2. Extensions of the neoclassical model in which managers are heterogeneous in their match quality with firms
        - Selected into a specific firm because of their style
- Two *managers matter* view of corporate practices: efficiency implications?
    1. Some managers' preferences and characteristics may result in firm choosing sub-optimal strategies
    2. Managerial differences in style would not lead to inefficiencies
- Not directly tested in this paper, though some preliminary evidence is provided

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3. Data

3.1 Sample Construction

- Want to see if there are significant manager FE in corporate practices
    - After controlling for all relevant observable firm-level characteristics (incl. firm FE)
    - $\rightarrow$ Need to separate manager FE from firm FE
- Manager-firm matched panal data set
    1. Forbes 800 files (1969-1999)
        - Information on the CEOs of the 800 largest US firms
    2. Execucomp data (1992-1999)
        - Names of the top 5 highest paid executives in 1500 publicly traded US firms
- CEO and other top executives (CFO, COO, and sub-division CEOs)
- Restriction:
    - Subset of firms for which at least one specific top executive can be observased in at least one other firm
    - Managers who are in each firm for at least 3 years
- About 600 firms and 500 individual managers

3.2 Corporate Variable

- COMPUSTAT and SDC: annual accounting variables
    - 3 different set of corporate decisions + corporate performance
        1. Investment policy,
        2. Financial policy, and
        3. Organisational strategy
- Summary Statistics: Table I and II

4. Method and Results

4.1 Manager Matters?

- Estimate three models: without manager FE, with only CEO FE, and with all the CEO FE:

$$y_{it} = \alpha_t + \gamma_i + \beta X_{it} + \lambda_{CEO} + \lambda_{CFO} + \lambda_{Others} + \varepsilon_{it}$$

  - Allocation of top executives to firms is not random... unable to causal effects
  - $rightarrow$ Assess if firm policies systematically change with top manager identity

Results

- Tables III and IV: F-tests and adjusted R^2 for different sets of corporate policy variables
  - Overall, manager FE matter economically and statistically for firm policies
  - Heterogeneity in corporate variables and in types of managers
- Table VI: variation in the size of manager FE... economically large
  - Incl. the variation in corporate performance FE
  - The median manager FE are not different from 0 in most cases
- Table V: robustness checks
  - Regressing a manager's average residual in the second firm on the residual in the firm firm
  - Placebo test by regressing pre-turnover residuals in the second firm on the average residual in the first firm

4.2 Any Management Style?

- Investigate if any patterns in managerial decision-making across different corporate variables
  - $\rightarrow$ Correlation structure b/w manager FE in different corporate practices

$$F.E.(y)_j = \alpha + \beta \cdot F.E.(z)_j + \varepsilon_j$$

Results

- Table VII
  - Difference in managers' approach towards external vs internal growth
  - Negative relationship b/w investment-Q and investment-cash sensitivities
    - Using different benchmarks?
  - Negative relationship b/w the leverage and cash holding FE
    - Difference in conservatism and aggressiveness in financing choices
  - Systematic relationships b/w manager FE in perfromance and in other practices

4.3 Interpretting the Manager FE

- Two different interpretations:
  1. Managers impose their style onto the firm (agency model)
  2. Managers with different skills are chosen by the firms to match their current strategic needs (optimal matching model)

- Provide some suggestive evidence against a pure optimal matching story

1. Certain manager styles correlate with manager FE in firm performance
   - Some styles are better for performance than others?
   - Or, some styles are better suited to economic downturn than others?
     - The latter interpretation may not be consistent with the results above
2. Manager FE in corporate performance systematically relate to the *good* governance indicator
   - Using the *fraction of shares held by large block holders* as a governance variable
   - Suggests that better governed firms select managers with *good* styles
3. Managers with high FE in performance earns higher compensation
   - Regressing Manager-specific compensation residuals on manager FE
   - Implies a premium for managers

4.4 Observable Characteristics of Managers and Corporate Policies

- Which managerial characteristics influence managers' decision-making?
  - Analyse two managerial characteristics: **MBA graduation** and **cohort/age**
  - MBA: human and social capital accumulation or selection effects?
  - Birth cohort: older generations are arguably more conservative?

Data and Method

- Data: focus on CEOs
  - CEO personal information from...
    - *S&P Directory of Corporate Executives*
    - *Who is Who of Corporate America*
  - No sample restriction on managers with transition
    - Incl. CEOs internally hired
- Method: regressing corporate variables on MBA and cohort dumies with other controls

$$y_{ijt} = \beta \cdot X_{it} + \delta \cdot MBA_j + \eta \cdot Cohort_j + \gamma \cdot Tenure_j + \alpha_i + \lambda_t + \varepsilon_{ijt}$$

  - Identification relies on *within-firm* variation

Results

- Table IX: systematic difference in corporate practices by two characteristics
  - CEOs with MBAs: more aggressive, and positively relates to corporate perfomance
  - CEOs from older birth cohort: les aggressive
- Overall, manager FE are partially attributable to observable individual characteristics