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The Impact of CEO Characteristics on Firm Value

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ABSTRACT

This paper examines the CEO (Chief Executive Officer) characteristics (CEO's independence, and financial experience) that have an impact on firm value (Return on Equity) with control variables (board size, and number of board meetings). The sample consists of 17 companies from 100 listed companies on the Egyptian Exchange (EGX), the selection of these companies is based on stringent criteria to ensure data reliability and consistency.

The study focuses on the period from 2015 to 2019, excluding the disruptive effects of the COVID-19 pandemic. Some statistics were used to get the results, such as descriptive analysis, descriptive statistics, normal distribution test, correlations test, autocorrelation test, multicollinearity test, and finally the empirical results. The results show that certain variables show marginal significance, but the overall explanatory power of the model is weak. Further investigation and refinement of the model may be necessary to better understand the factors influencing financial performance in the Egyptian market.

KEYWORDS

Firm Value, CEO Characteristics, ROE, Financial Experience, CEO's Independence.

1. INTRODUCTION

The CEO plays a crucial role in a company's success or failure, leading the company in aggressive pursuit of opportunities and controlling its structure and strategy. Their performance and qualifications are crucial for the company's survival and success. However, financial and accounting irregularities, scandals, and CEO investments have been documented for years. The Satyam incident in India sparked debates about the CEO's role in leading companies to success. CEO characteristics, such as personality and leadership, can significantly impact a firm's success. This paper focuses on these characteristics and their influence on companies, providing a literature review, information on the relationship between those characteristics, firm performance, and financial reporting quality (Hamori, M., & Koyuncu, B., 2015).

The research aims to understand how CEO characteristics, including independence, financial experience, board size, and board size, influence the ROE, providing insights into decision-making processes, corporate culture, and stakeholder relations, thereby enhancing the overall ROE.

This research aims to study the correlation between CEO characteristics (independence and financial experience) and their impact on company valuation. However, the study faces challenges due to the lack of measurement of these characteristics, which include their approach, reactions, and personality. Additionally, the study tests whether CEO characteristics influence firm performance, but it also considers the possibility of reverse causality, which could lead to biased results.

2. RESEARCH IMPORTANCE

A crucial area of study that connects the domains of management, finance, and organizational behavior is the connection between CEO characteristics and firm value. The personal characteristics, leadership style, and decision-making procedures of CEOs, who are frequently regarded as the most powerful individuals in a company, can significantly affect the strategic direction, risk profile, and financial performance of the organization. Investors, legislators, and corporate boards looking to maximize firm value and long-term sustainability must comprehend these dynamics.

This study investigates the relationship between firm value and CEO characteristics. Investors, legislators, and corporate boards must comprehend these linkages since CEOs have a significant impact on a company's strategy, performance, and market valuation. The research offers insights that can direct leadership selection, enhance governance procedures, and assist businesses in streamlining decision-making processes by determining which characteristics are most linked to effective outcomes.

3. LITERATURE REVIEW

3.1 The Independent Variable (CEO characteristics)

CEO Experience

CEO experience, including tenure, industry expertise, and prior leadership roles, is crucial for strategic decision-making and organizational resilience. Studies have shown that CEO tenure and stock prices significantly influence firm value, while capital structure has no significant impact. Research by Mulyati, Y. (2021) found that CEO tenure is crucial for strategic business development, and the Debt Equity Ratio indicates a positive correlation between these

factors and firm value. Monika Hamori and Burak Koyuncu (2015) found that experience in the CEO position is negatively related to firm performance.

Ismaila, Alhaji, and Tanko (2023) conducted a study on the impact of CEO characteristics on the firm value of listed insurance companies in Nigeria from 2013 to 2022. The results showed a positive correlation between CEO tenure and firm value, attributing it to accumulated experience. However, CEO duality was associated with a negative impact on firm value, possibly due to reduced openness to employee input due to the CEO's powerful position.

Nguyen, Rahman, and Zhao's (2018) study provides valuable insights into the contingent relationship between CEO characteristics and firm valuation within the Australian context. The findings have implications for corporate governance practices and policy recommendations, highlighting the importance of empirical research in informing decision-making processes.

Ruonan Liu and Zhenfeng Liu (2020) investigated the CEO horizon problem and its mitigation by the board of directors, particularly compensation committees. The study found that retiring CEOs are more likely to reduce R&D expenditures when they wield more power and when director tenure is longer. Larger boards of directors and compensation committees also decrease the likelihood of accruals management when CEOs face the horizon problem.

CEO Independence

Ronald W. Masulis (2020) examines the relationship between boards of directors and CEO incentives, focusing on their impact on firm performance and shareholder wealth creation. He finds a reciprocal relationship between boards and CEOs, with boards exerting strong incentives on CEOs and vice versa. The study also explores the impact of director characteristics on firm performance, finding that independent directors with stronger reputation incentives and social independence tend to enhance firm performance. However, affiliated directors do not contribute significantly to firm performance. Masulis raises questions about the optimal composition of boards and the role of independent directors, suggesting future research should focus on improving ID information access and exploring the relationship between boards and creditors. The study highlights the importance of considering director independence when analyzing director characteristics.

Other CEO Characteristics

(Razak, L. A., & Badollahi, I., 2020) This study examines the role of CEO narcissism in increasing company value from 2015 to 2019. The research was conducted on state-owned companies listed on the Indonesia Stock Exchange. The study found that CEO signature size has a substantial negative impact on company value, as they tend to engage in risky business activities, reducing investor response. Credible CEO activism has a positive correlation with firm value, but this effect is reduced when CEOs are entrenched due to corporate governance provisions, substantial ownership, or family ownership.

The study also examines the relationship between CEO pay ratio and firm value/performance. Contrary to critics' arguments, industry-adjusted CEO pay ratios are positively associated with firm value and performance. However, high CEO pay ratios may lead to lower firm values and poor operating performances, as workers may perceive unfairness.

The study investigates the effect of control mechanisms on CEO power and firm value relationships. It finds that market competition and corporate governance have a positive effect on CEO power and firm value relationships. The study also examines the impact of founder CEOs on firm value in the context of business groups. The results show that firms with founder CEOs have lower firm value than those with non-founder CEOs.

The study also investigates the relationship between CEO characteristics and firm value in the Indonesian banking industry. Results show that ROA, leverage, and financial condition as control variables do not significantly influence firm value. However, the financial condition of the company, such as DAR, ROA, and LOSS, has a significant influence.

The literature review by Chia-Hsien Tang explores the interplay between CEO overconfidence and firm value following mergers and acquisitions (M&A). Young CEOs emerge as significant contributors to the positive impact of CEO overconfidence on firm value after M&A. Female CEOs demonstrate a greater propensity for risk aversion compared to their male counterparts, leading to lower leverage and reduced volatility in firms run by female CEOs.

3.2 Control Variables

Board Size

The study by Hanen Ben Fatma and Jamel Chouaibi (2023) explores the impact of corporate governance mechanisms on the firm value of European financial institutions. The research highlights the importance of board characteristics and ownership structure in shaping firm behavior and outcomes. The study finds that board gender diversity and CEO ownership positively impact firm value, while larger boards and concentrated ownership have a negative relationship. The findings have implications for investors, financial institutions, and policymakers. Investors should prioritize effective corporate governance practices, while financial institutions should prioritize board diversity and CEO ownership. The study also identifies areas for future research, including exploring firm value across different European industries and investigating additional dimensions of corporate governance.

Number of board meetings

Buchdadi et al. (2019) conducted a study on the impact of board of director meetings, board of director join meetings with executives, and attendance on firm performance in 135 companies from 2013-2016. The results showed a positive correlation between these factors.

3.3 The Dependent Variable (Firm Value)

Firm Value is a metric that measures a company's overall worth and success, based on financial indicators and market-based measures. Research shows that CEO characteristics, such as gender, MBA degree, and tenure, do not affect firm value. Instead, ROA, leverage, and financial condition as control variables have an effect. This suggests that company policies are based on all members of the board or top management team, not just the CEO (Sucma Berlian, Hadi Sumarsono, Dwi Warni Wahyuningsih, 2022).

4 RESEARCH HYPOTHESIS

H1 There is a significant relationship between CEO financial experience and ROE.

CEOs' financial experience significantly impacts a company's Return on Equity (ROE). They have a deeper understanding of financial markets, risk management, and capital allocation, enabling them to make strategic decisions that improve the company's profitability. A positive correlation between CEO financial expertise and higher ROE. CEOs with financial expertise can identify opportunities to improve ROE, such as optimizing capital structure, enhancing operational efficiency, and making informed investment decisions. This highlights the importance of leaders who can strategically manage financial resources for maximum shareholder returns (Kim, W. S., & Kiymaz, H., 2023).

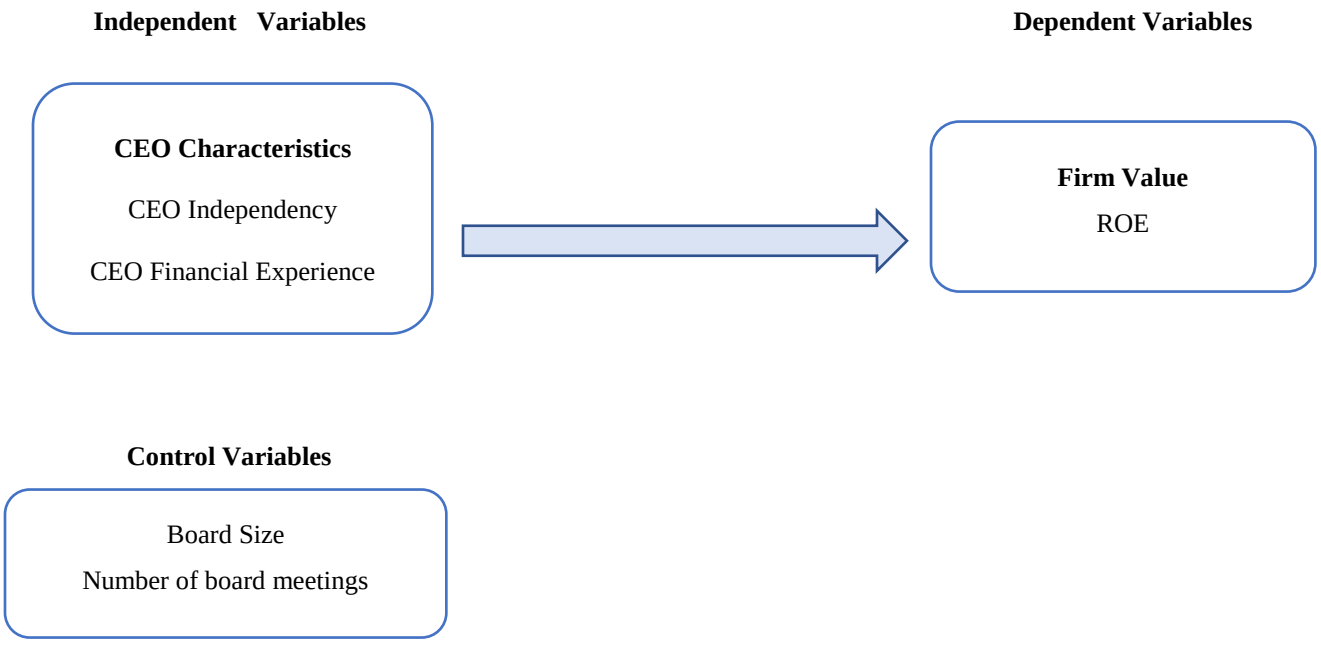
H2 There is a significant relationship between CEO independence and ROE.
The relationship between CEO independence and Return on Equity (ROE) is crucial for corporate governance and financial performance. Independent CEOs make unbiased decisions, contributing to improved financial performance and shareholder value. However, the relationship is nuanced and context-dependent, with some studies highlighting the positive impact of independence while others argue for a balance between independence and industry expertise. Therefore, a nuanced understanding is needed to fully understand this complex relationship.

H3: There is a significant relationship between board size and ROE.
The relationship between board size and a firm's Return on Equity (ROE) is a key area of corporate governance research. An optimal board size is crucial for effective communication and decision-making. Brown et al. (2019) suggest that the relationship depends on the industry context, with larger boards being beneficial in certain sectors and smaller boards being more effective in others. This highlights the need for context-specific considerations in corporate governance.

H4: There is a significant relationship between the number of board meetings and ROE.
The frequency of board meetings significantly impacts a company's financial performance, particularly its Return on Equity (ROE). A higher number of meetings enhances corporate governance, allowing board members to discuss strategic decisions, leading to informed decisions and improved financial health. However, the relationship between board meetings and ROE may vary based on industry dynamics and firm size. Understanding the specific needs of an organization is crucial for determining the optimal number of meetings to maximize ROE.

5 RESEARCH MODEL

Figure 1: Conceptual Framework



6 RESEARCH METHODOLOGY

The study focuses on 17 Egyptian companies listed on the Egypt Bourse, excluding those affected by the COVID-19 pandemic. Data is collected from the Investors' Guide and the annual reports of the selected companies, ensuring reliability and consistency. The data is sourced from the Egyptian Bourse for comprehensive coverage and credibility. The aim is to provide insights into the financial performance of these companies and their impact on their value.

6.1 Measurement of Variables

Table 1: Measurement of Variables

Independent Variables	Label	Measurement	Definition
Experience	EXP	Dummy variable, 1 if the CEO is independent, 0 if the CEO is not independent.	Practical knowledge, skill, or practice derived from direct observation of or participation in a particular activity (Mulyati, 2021)
Independence	IND	Dummy variable, 1 if the CEO has Experience, 0 if otherwise	Independent is not influenced or controlled by others in matters of opinion and conduct (Nguyen, 2018)
Dependent Variable	Label		Definition
Return on equity	ROE	$ROE = \frac{Net\ Income}{Shareholders' Equity}$	It is a measure of financial performance calculated by dividing net income by shareholder's equity
Control Variables	Label		Definition
Size of the board of directors	SBOD	Dummy variable, 1 more than or equal to 5, 0 if Otherwise	It is an executive committee that jointly supervises the activities of an organization (Ben Fatma, 2023)
Number of board meetings	NOBM	Dummy variable, 1 if more than or equal to 5, 0 if otherwise	It is a regular formal gathering of a board of directors in order to discuss strategic matters of the company (Fernández-Temprano, 2020)

6.2 The Relationship Between Variables

The correlation analysis shows a positive relationship between CEO independence and firm value, but a negative relationship with CEO experience, board size, and number of meetings. As CEO independence increases and experience grows, the firm's ROE increases.

6.3 Significance of the Study

The study examines 17 Egyptian EGX 100 companies' value from 2013 to 2020, focusing on return on equity and CEO manager characteristics. It aims to provide insights into the impact of CEO independence on firm value, a gap in existing research.

6.4 Study Model

$$ROE = \beta 0 + \beta 1\ EXP_i + \beta 2\ IND_i + \beta 3\ SBOD_i + \beta 4\ NOBM_i + \varepsilon i \ .....$$

Where:

ROE: is the dependent variable and the value of voluntarily disclosed information by listed institutions.

β0: is the constant.

β1..4: is the slope of independent and control variables.

EXPi: Dummy variable coded 1 if the CEO had experience, 0 if not (i).

INDi: Dummy variable coded 1 if the CEO is dependent, 0 if otherwise (i).

SBODi: Dummy variable coded 1 if the size of the board of directors is more than or equal 5, 0 if otherwise (i).

NOBMi: Dummy variable coded 1 if the number of board meetings is more than or equal 5, 0 if otherwise (i).

Ɛi: is random error.

7. EMPIRICAL RESULTS

7.1 Descriptive Analysis

Year	Variable	N	Mean	Std. Deviation
2015	EXP	17	0	0
	IND	17	0.65	0.493
	SBOD	17	0.94	0.243
	NOBM	17	0.82	0.393
2016	EXP	17	0	0
	IND	17	0.76	0.437
	SBOD	17	0.94	0.243
	NOBM	17	0.82	0.393
2017	EXP	17	0	0
	IND	17	0.71	0.47
	SBOD	17	0.88	0.332
	NOBM	17	0.76	0.437
2018	EXP	17	0	0
	IND	17	0.65	0.493
	SBOD	17	0.88	0.332
	NOBN	17	0.71	0.47
2019	EXP	17	0	0
	IND	16	0.63	0.5
	SBOD	17	0.88	0.332
	NOBN	17	0.76	0.437

Table 2: Descriptive Analysis

The EXP variable indicates CEO experience, with an average of 0 across all years from 2015 to 2019, indicating no variation in CEO experience within each year.

The IND variable indicates CEO independence or dependency, with a mean of 0.63-0.66, and a standard deviation of 0.437-0.5, indicating slight variation within each year.

The variable SBOD represents the size of the board of directors, with a high mean and low standard deviation across all years, indicating a larger board size in the sampled companies.

The variable NOBM represents the number of board meetings held by the sampled companies, with an average of over 5 meetings held annually and a standard deviation of 0.393 to 0.5.

7.2 Descriptive Statistics

Table 3: Descriptive Statistics

Year	Variable	N	Mean	Std. deviation
2015	ROE	17	0.63382	0.806893
2016	ROE	17	0.47994	0.903676
2017	ROE	17	0.5365	0.9936509
2018	ROE	17	0.482447	1.0460225
2019	ROE	17	0.84412	2.394505

The average Return on Equity (ROE) for a sample of companies in 2015 was moderately high, with a standard deviation of 0.81. However, in 2016, it decreased to 0.48, indicating increased variability. In 2017, it slightly increased to 0.54, indicating further variability. In 2018, it decreased to 0.48, indicating even greater variability. In 2019, it increased to 0.84, indicating a higher level of variability. This suggests potential financial performance shifts during those years.

7.3 Normal Distribution Test

Table 4: Normal Distribution Test

Year	Variable	Jarque-Bera (JB)	P-value	Skewness	Kurtosis
2015	EXP	0	0	0	0
	IND	17.38861585	0.999832463	01.766233766	00.676692292
	SBOD	187	1	17	04.123105626
	NOBM	11.1296259	0.996169703	1.665306122	01.866213097
2016	EXP	0	0	0	0
	IND	12.36137041	0.99793099	00.149450549	01.3722525
	SBOD	187	1	17	04.123105626
	NOBM	11.1296259	0.996169703	1.665306122	01.866213097
2017	EXP	0	0	0	0
	IND	15.08906722	0.999471006	01.165714286	00.993609209
	SBOD	23.51234321	0.999992159	5.44	02.609611863
	NOBM	12.36137041	0.99793099	00.149450549	01.3722525
2018	EXP	0	0	0	0
	IND	17.38861585	0.999832463	01.766233766	00.676692292
	SBOD	23.51234321	0.999992159	5.44	02.609611863
	NOBN	15.08906722	0.999471006	01.165714286	00.993609209
2019	EXP	0	0	0	0
	IND	18.16954977	0.999886621	01.934065934	00.571428571
	SBOD	19.13804383	0.99993014	5.44	02.294821061
	NOBM	12.36137041	0.99793099	00.149450549	01.3722525

The table provides no information on the normality of EXP, IND, SBOD, and NOBM variables. The IND and NOBM variables have high p-values, skewness, and kurtosis values within the expected range, suggesting a closer distribution to normality. However, there are inconsistencies in the provided data for SBOD and NOBM, making it difficult to assess their normality. Further analysis may be needed to confirm the normality of these variables.

7.4 Correlations

Table 5: Correlation

Year	Correlation	EXP	IND
2015	EXP	1،000	0
	IND	0	1،000
2016	EXP	1،000	0
	IND	0	1،000
2017	EXP	1،000	0
	IND	0	1،000
2018	EXP	1،000	0
	IND	0	1،000
2019	EXP	1،000	0
	IND	0	1،000

The EXP and IND variables show a perfect, positive correlation from 2015 to 2019, indicating a strong linear relationship across all years analyzed.

7.5 Autocorrelation Test

Table 6: Autocorrelation Test

Year	Model	PRESS	Durbin-Watson
2015	1	14،867	1،553
2016	1	19،254	2،224
2017	1	24.754	2.223
2018	1	23.342	2.277
2019	1	126.534	1.890

The analysis shows slight positive autocorrelation in residuals in 2015, 2016, 2017, and 2018, with moderate predictive performance. However, 2019 has a poorer predictive performance, affecting the reliability of the regression analysis. Further investigation and model refinement may be necessary to improve predictive accuracy and address autocorrelation issues, potentially impacting the reliability of the regression analysis.

7.6 Multicollinearity Test

Table 7: Multicollinearity Test

	2015		2016		2017		2018		2019	
Variable	Tolerance	VIF	Tolerance	VIF	Tolerance	VIF	Tolerance	VIF	Tolerance	VIF
EX	0	0	0	0	0	0	0	0	0	0
IND	0.863	1.159	0.905	1.105	0.863	1.159	0.999	1.001	0.973	1.027
Control variables										
SBOD	0.949	1.054	0.956	1.046	0.949	1.054	0.998	1.002	0.948	1.055
NOBM	0.851	1.176	0.911	1.098	0.851	1.176	1	1	0.936	1.068

The study found that EXP, IND, SBOD, and NOBM have low multicollinearity across all years and years, indicating they can be considered independent predictors in regression analysis without multicollinearity issues.

7.7 Empirical Results

Table 8: Empirical Results

Variables Label	**t-test**	**Sig.**
Independent variables		
EX	.964	.338
IND	01.690	.095
Control variables		
SBOD	.095	.353
NOBM	0.057	.954
Model Summary		
R	.208	
R Square	.043	
Adjusted R Square	.007	
Std. Error of the Estimate	1.3384914	

The correlation coefficient (R) indicates a weak positive correlation between the dependent and independent variables. The R Square (Coefficient of Determination) represents the proportion of variance in the dependent variable that is predictable from the independent variables. The adjusted R Square (0.007) indicates that the model does not fit the data well after adjusting for the number of predictors. The standard error of the estimate (1.3384914) represents the standard deviation of the residuals, indicating a poor fit of the model.

The independent variables, EX and IND, have t-tests with significance levels of 0.338 and 0.095 respectively, indicating no statistical significance. The control variables, SBOD and NOBM, have t-tests with significance levels of 0.095 and 0.954 respectively.

8. CONCLUSION AND RECOMMENDATIONS

8.1 Conclusion

The study reveals that the financial performance and corporate governance characteristics of Egyptian companies listed on the Egypt Bourse (EGX 100) from 2015 to 2019 were influenced by CEO characteristics, board size, and meeting frequency. CEOs generally lacked prior experience, but their independence showed some variability over the years. Boards of Directors (SBOD) and meeting frequency (NOBM) were also influenced by these factors. Return on Equity (ROE) varied over the years, with significant increases in both mean ROE and variability.

The study found that CEO independence (IND) showed characteristics closer to normal distribution, while CEO experience and board size were not statistically significant. Autocorrelation tests showed slight positive autocorrelation in 2015 and 2019, with 2019 having poorer predictive performance.

The model's overall explanatory power is weak, with low R Square and Adjusted R Square values. Further investigation and refinement may be necessary to better understand the factors influencing financial performance in the Egyptian market. Further investigation on CEO experience (EXP), CEO independence (IND), board size (SBOD), and meeting frequency (NOBM) could help identify the underlying factors driving these fluctuations. Additionally, conducting regression analysis with additional explanatory variables could enhance the model's predictive power and identify significant drivers of financial performance.

8.2 Recommendations

The text suggests several strategies for Egyptian companies to improve their corporate governance practices, and financial performance, and achieve sustainable growth.

First, structured CEO development programs can provide aspiring executives with the necessary skills and experience to lead organizations effectively.

Second, larger boards and more meetings can enhance board effectiveness by conducting evaluations, providing training, and encouraging active engagement.

Third, reviewing CEO independence policies can help maintain transparency, accountability, and investor confidence.

Fourth, fostering a culture of continuous improvement and learning can help companies remain agile and resilient in the face of uncertainty and change.

Fifth, companies should engage in benchmarking and best practices to identify areas for improvement and adapt strategies to suit their context and objectives.

Finally, companies should stay updated on regulatory changes to mitigate legal risks and uphold corporate governance standards. By implementing these recommendations, Egyptian companies can enhance corporate governance practices, strengthen financial performance, and achieve sustainable growth in a dynamic business environment.

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