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CEO Attributes in the Context of Financial Distress Likelihood

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Abstract: The empirical literature highlights the importance of CEO attributes in the paradigm of firm's financial distress likelihood. The position of the CEO has been given considerable attention in the global competitive corporate environment. In view of this uprising importance of CEO position, we investigate the case of 59 listed manufacturing firms in Nigeria to unravel the effect of CEO attributes: CEO gender and CEO nationality on financial distress likelihood. We employ Logistic regression analyses technique for analysing the data of the sampled firms collated for the period between 2010 and 2019. Based on the result obtained from the logistic regression analyses of manufacturing firms in Nigeria for the period under investigation we find that CEO gender diversity has a significant negative effect on financial distress likelihood finding consistence with the resource dependence theory which posit that female directors (female CEO) bring to the board different perspectives and experiences thus will most likely protect the interest of the firm and shield her from financial distress situations. Therefore, we carefully recommend that adopting policies such as "gender quotas" that will allow women act as CEOs' will go a long way up to extend a organizations' life span.

Keywords: CEO Attributes, Financial Distress Likelihood, CEO Gender, Logistic Regression

1. INTRODUCTION

Predicting the probability of firms' financial distress has always been the interest of scholars in corporate finance, hence in recent years a rise in the need to pay indebt attention to corporate governance factors as a checker or preventive tool of financial distress has been largely noticeable. For example, Thornhill and Amit (2003) suggest that financial failure among firms may be attributable to deficiencies in managerial knowledge and financial management abilities. Similarly, Bennedsen, Perez-Gonzalez and Wolfenzon (2010), Barno, (2017) allude to the fact that CEOs position is prime to the determination of a firms' success because the CEO is the team leader who

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exercises critical strategic control, monitoring and decision making. Further, Gathaiya (2017) concludes that the major contributors to financial distress in most financial institutions relates to insider lending, weak corporate governance practices, weaknesses in regulating and supervising body, risky management strategies, ineffective internal control systems and conflict of interest which all point to leadership failure or better still CEO failure. Therefore, the role of the CEO becomes critical if occurrence of financial distress must be curtailed. Kumar, (2015) noted that although organizations exist to achieve goals, there is an essential belief that management must equip themselves with systems' skills which suggest that CEOs have greater role in organizational performance. From the agency perspective, CEOs are often required to possess diverse skills for effective management.

Extant studies have shown that CEO characteristics such as age, tenure, duality, and ownership have significant impact over the firm's financing and investment policies (Alexander & Lee, 1996; Nourayi & Mintz, 2008; Yasser et al., 2011) suggesting that these attributes can also have an impact on the firm's possibility of distress and need to be examined. Nigeria is a developing country, and its corporate governance landscape is still fledging compared to the developed world. In Nigeria, corporate governance code was first introduced in 2003 (Security & Exchange Commission of Nigeria, SEC 2003) and have been followed by updates up until recently in 2020. Compared to related studies from the developed world, corporate governance and particularly the role of the CEO has not been the focus of regulators, firm managers and even scholars in Nigeria (Nworji, Adebayo, & David, 2011). Therefore, the Nigerian corporate market can be taken as an interesting natural laboratory to test existing theories.

To the best of our knowledge, no study has paid attention to the effect of CEO characteristics on probability of firm financial distress in Nigeria. Hence, the contribution of this study is two folds. First, it adds to the important literature on corporate governance from the Nigerian context and second, it contributes fresh evidence on financial distress literature in Nigeria. The rest of the paper is organized in the following manner. The next section builds on a review of key concepts, theoretical framework, and review of related existing literature. Section 3 presents data collection and methodology. Analysis and results are presented in section 4 while section 5 offers the conclusion and important implications

2. LITERATURE REVIEW

Financial Distress

Financial distress is a situation in which companies' cash flow becomes insufficient to cover their obligations. These obligations can include unpaid debts to suppliers and missed principal or interest payments under borrowing contracts, which signifies that distress is imminent. Ehab, Rahim and Ananth (2011) defined financial distress as a state where a borrower is unable to meet payment obligation to lenders and creditors due to reputation, leverage, volatility of earnings, collateral, economic condition, or interest rates. Financial distress itself is a condition in which the company is unable to maintain its going concern, which brings about consequences in the form of bankruptcy, delisting, or organizational restructuring (Muller, Steyn-Bruwer & Hamman., 2009). Extant literature on financial distress revealed two important issues as potential causes: the inability of credit institutions and financial creditors to anticipate and prevent situations of financial distress; and ignorance about the importance of the effectiveness of corporate governance mechanisms (Husson-Traore, 2009), for example, the cases of the Lehman Brothers bankruptcy in 2008 and Enron in 2001; the case of PT Kimia Farma in 2001, Lippo bank in 2003 in Indonesia, Cadbury in 2008 and Oceanic

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bank in Nigeria. similarly, Avramov, Chordia, Jostova and Philipov (2013) posit that credit rating downgrade can be a warning sign to a firm's conditions, raising issues on its future financial performance. Particularly, Richardson, Lanis and Taylor (2015) noted that during periods of financial distress firms may be compelled to undertake risky and aggressive tax avoidance strategies.

Economic Cost of Financial Distress

One of the most significant issues confronting firms during financial distress is the inability of managers to persuade external stakeholders such as creditors and suppliers to continue doing business with the distressed entity (Sautner & Vladimirov 2016). The norm is that as distress progresses to the possibility of bankruptcy, many stakeholders start jumping ship which can speed up the rate of deterioration of the financial position of the firm. The cost associated with this phenomenon whereby stakeholders dissociate themselves from distressed firms and its resulting consequences is referred to by Altman (1984), Opler and Titman (1994), and Bris, Welch, and Zhu (2006) as an indirect cost of financial distress. Sautner and Vladimirov (2016) explained that indirect cost arises from deflated access to trade credit and foregone revenue from customers. In the views of Opler and Titman (1993), stock prices decline significantly when firms enter a state of financial distress as revenue from direct sales diminishes.

CEO Gender

Considering the gender of CEOs, cognitive psychology and management research suggests that women and men are different, for example, in leadership styles, effectiveness, communicative skills, conservatism, aggressiveness, risk averseness, and decision-making. Fondas & Sassalos (2000) suggest that women bring different points of view and ideas to discussions and hence enhance decision-making. Differences in attitudes between women and men could lead to differences in investment and financing decisions made by female and male CEOs. Specifically, female CEOs may invest less and choose to use less debt in the firm's capital structure, compared with male CEOs.

CEO Nationality

The CEO's international experience can help the company create global competitiveness through international diversification. Such experience can develop the ability of executives to deal with unexpected problems and new challenges. Further, this experience equips executives with skills not available in their own countries. Therefore, international experience has become a prerequisite for the position of CEO (Bass; Black, Gregersen, Mendenhall, & Stroh 2015; Daily, 2014). Therefore, companies continue to demand and reward CEOs with international experience, especially in the era of globalization (Sanda, Garba, & Mikailu 2008; Wah, 2015). In this regard, companies are only trying to attract foreign executives who can provide management talent and technical skills. The high-level echelon theory also encourages the arrival of foreign CEOs to improve the operational efficiency and monitoring capabilities of the organization (Hambrick & Mason 1984).

CEO Gender and Financial Distress

It is claimed that demographic diversity of leadership is positively associated with diverse practices that impact organization performance. Nishii, Gotte, & Raver, (2007) suggest that men and women tend to differ in decision making. Barno (2017) established a negative significant impact of gender diversity on capital structure indicating that gender has effect on decision making. Similarly, Gorts (2016) adds that gender influences corporate financial strategy. Additionally, Vo and Phan (2013) propose involvement of female in corporate decision making since it positively affects performance of the firms which connotes that inclusion of female in leadership positions influence decision

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making. Furthermore, Shungu, Ngirande, & Ndlovu (2014) concludes that there exists a positive association between board of directors' gender diversity and bank performance proposing that gender influence firm performance. Kyenze (2014) however found that there is no statistically significant connection between the gender of the CEO and firm performance implying that gender did not influence organizational performance. Equally, Chan and Heang (2010) opined that there is no significance influence between gender diversity and cost signifying that gender did not have influence on overall firm output.

CEO Nationality and Financial Distress

The link between nationality and business is one not fully explored, as limited amounts of research has been conducted in this area. Rahman et al. (2017) found that CEO nationality is significantly related to profitability. Similarly, Nielsen & Nielsen (2013) noted that not only is nationality diversity significantly positively linked to capital structure, but the strength of the effect increased with time, team tenure, firm internationalization, and industry munificence. Jalbert et al. (2007), used nationality as a proxy for cultural differences and reported a negative relationship between CEO birthplace and leverage ratio. Pan et al. (2018) studied the attitudes of CEOs towards risk-taking, by utilizing Hofstede's (1980, 2001) uncertainty avoidance index (UAI) as a proxy for cultural heritage and found a negative relationship between UAI and spending on mergers and acquisitions, meaning that cultural heritage seems to have a noticeable effect on risk behaviour of U.S. CEOs. However, on the contrary, some scholars believe that foreign executives have a low attendance rate, and because they live abroad, their supervisory role is weak. In addition, language barriers and unfamiliar or superficial knowledge of local culture, market and economy can also reduce their efficiency (Arioglu & Borak 2015)

Theoretical Framework

The Upper Echelon Theory (UET) builds on the stance that personal characteristics found in top management teams are factors that affect an organisation's strategic choices, which in turn affect the performance of the organisation (Hambrick & Mason 1984). With this theory, Hambrick & Mason (1984) attempt to explain a firm decision by applying different psychological, sociological, and economically oriented perspectives on the board, and thus offering a better explanation of the behaviour of an organisation. A central concept within the UET is the idea of bounded rationality, which refers to the limitations in human complex decision making (Cyert & March 1963). As stated by March & Simon (1958), rational decision-making behaviour only appears if certain 'givens' can be identified regarding a specific situation. Hambrick & Mason (1984) define these givens as an individual's cognitive base, which consists of (1) knowledge or assumptions about future events, (2) knowledge of alternatives, (3) knowledge of consequences attached to alternatives, and (4) rules or principles for ordering consequences or alternatives according to preferences (March & Simon, 1958). What this means is that decisions are made based on the information that is available and can be processed during the limited time available for decision making.

Empirical Review

Predicting the Risk of Financial Distress using Corporate Governance Measures in China was examined by Lia, Crook, Andreeva, and Tang (2011). The authors identified corporate governance as the independent variable proxied in terms of board size, independent directors, number of supervisors, number of senior managers, duality of CEO, and independent director monitoring. Ownership structure was also identified as the explanatory variable measured in terms of state-owned enterprise, board shares and supervisors' shares. To analyze the data set, logistic regression and the

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results suggest that although corporate governance alone is not sufficient to accurately predict financial distress, it adds to predictive power of financial ratios and macroeconomic factors.

Mittal and Lavina (2018) empirically examines females' representation (gender diversity) on the board as well as their impact on financial distress by taking the sample of Indian listed family firms for a period ranging from 2013 to 2016. The independent variables of the study were percentage of females on the board, female chief executive officer, female chairperson and female family member on the board while financial distress is the dependent variable. Applying logistic regression, the results of the study reveal that on average, there is just 9 percent share of females on the board to a maximum of 28 percent and only 2 percent of firms have female chief executive officer (FCEO). Further, females have a diminutive impact on financial distress since their presence on the board is very low. Only one variable, females' percentage on the board is significant and negatively associated with financial distress. However, other insignificant variables are negatively related with financial distress

Bharbra and Eissa (2017), examined corporate financial distress and CEO networks with time frame from January 2003 to December 2015. The independent variable of Board Size, CEO Tenure, Director Role in the company, variability of director age and variability of the number director academic achievements were collected from BoardEx while the dependent variable was financial distress proxied by audit concern, credit rating downgrades, and violations of debt covenants. Logistic regression results of the study indicate that CEOs occupying central locations in the vast network of corporate directors are more likely to experience an event of financial distress than a similar firm with a less central CEO.

Rono, (2018) studied the Effects of Chief Executive Officer attributes on financial distress in commercial banks in Kenya. The study employed secondary method of data collection. The analyzed data were obtained from Central Bank of Kenya annual supervisory report available in financial annual reports of commercials banks' available on their individual website. The period under study was one year (2016). Secondary data was examined and presented using descriptive statistics, univariate analysis and multi discriminant analysis. Financial distress as the dependent variable is determined using the Altman Z-Score model. The explanatory variables of the study were age of CEO, education of CEO, gender of CEO, Tenure of CEO and experience of CEO. The results of the study showed that there is presence of financial distress in both tier II and tier III commercial banks in Kenya. The main factor that was found to influence the extent of financial distress in commercial banks is CEO tenure.

3. Methodology

This study relied on ex post facto research which attempts to determine causal relationships between events and circumstances after they have occurred. The population of this study is made up of manufacturing firms from 6 sectors and are listed on the floor of the Nigerian stock exchange market for the period between 2010 and 2019. As of 31st December 2019, the total number of listed firms in these sectors are Agriculture (5); Conglomerates (5); Consumer Goods (19); Industrial Goods (15); Natural Resources (4); and Healthcare (11) making a total of 59 manufacturing firms**.** However, firms that got listed after the start date of the study period (2010) were deselected bringing down the sample size to 50 manufacturing firms. In this study, we employed Altman Z-score to filter the sample into Financially Distressed and Financially Healthy firms. Logistic regression technique is used in this study because statistically, logistic regression seems to fit well with the features of the

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distress prediction problem, where the dependent variable is binary and with the groups being discrete, non-overlapping and identifiable (Ciampi 2015).

Measuring Financial Distress

In this study we focus on the probability of financial distress, measured by Edward Altman's Z-Score models, which have become a popular and widely accepted measure of financial distress. The Z-score uses multiple inputs from corporate income statements and balance sheets (Statements of Financial Position) to measure the financial status of a company. The table below provides a summarize guideline for measuring financial distress with Z-score.

Table 1. Edward Altman Guidelines

Situation	Z-Score	Zones	Remark
i.	Below 1.9	Distress Zone	Failure is Ascertained
ii.	1.9 to 2.9	Gray Zone	Can't' Tell
iii.	Above 2.9	Healthy Zone	Will not Fail

Source; Shahwan, (2015)

From the table above, a firm with Z-Score below 1.9 falls in the distressed zone. Its failure is certain and could occur probably within a period of two years; If a firm has a Z-Score between 1.9, and 2.9, its financial viability is somewhat healthy. However, failure in this situation is uncertain to predict; and Z-Score of above 2.9 implies that the firm is in the 'very healthy' zone. Its financial health is very viable, and the company will not fail. For this study, our sample constitute firms in the distress and healthy zones since at these zones, a state of failure or healthy is easily predicted unlike the grey zone. Succinctly, we selected healthy firms and distress firms from a sample of healthy, gray and distress firms. We modified the studies of Shahwan, (2015) and Parkinson, (2018) to express the econometric equation as:

Model Specification

$$\boldsymbol{FDIST_{it} = \beta_0 + \beta_1 CEOG_{it} + \beta_2 CEON_{it} + \beta_3 ROE_{it} + \mu_{it}}$$

Where:

FDIST represents financial distress employed as a dichotomous variable of "0" for ***healthy*** firms and "1" for ***distressed*** Firms. CEOG represents CEO Gender which is measured as "1" for Companies that employed Female CEOs during the period under investigation and "0" otherwise. CEON represents CEO Nationality which is measured as "1" for Companies that have foreign CEOs during the period under investigation and "0" otherwise. We employed Return on Equity (ROE) measured as the ratio of profit after tax to total equity to control the model. β_0 represents the constant term; β_1- β_3 represents the Slope of the Coefficient; represents the stochastic disturbance; "i" is the i^{th} firm; and "t" is the time.

4. Results and Discussion of Findings

To examine the effect of CEO attributes on financial distress likelihood, we first conduct pre-regression statistics (descriptive statistics). The descriptive statistics gives insight into the nature of the sample firms in this study. The result is shown below:

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Table 4.1 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
fdist	338	.4940828	.5007062	0	1
ceog	333	.048048	.2141896	0	1
ceon	333	.3273273	.469944	0	1
reta	338	4.165769	14.82617	-74.01	53.96

Authors Computation 2021

From the table above, we observe that on average, 49% of the firms in our sample constitute firms within the financial distress zone while 51% constitute firms in the healthy zone. On average, we find that only 33% of the firms in our sample used foreign CEOs while 5% of the CEOs of the firms under consideration were females. The table also shows that on average, the control variable of return on equity is 4.17 with a standard deviation of 14.83 during the period under investigation.

Table 4.2 Logistic Regression Estimates (Marginal Effect)

Variables	CEO Gender	CEO Nationality	Return on Equity
Financial Distressed Model			
Coefficient z_ Statistics Probability_z	-0.364 (-2.58) {0.010} **	-0.142 (-3.53) {0.000) *	-0.028 (-13.97) {0.000) *
No. of Obs = 332 Prob. > chi2 = 0.0000 Pseudo R-Square = 0.3988			

Note: t-statistics and respective probabilities are represented in () and {}
Where: ** represents 5% & * represent 1% level of significance

Authors' Computations (2021)

The table above shows the result obtained from the logistic regression model employed to test the effect of CEO attribute on financial distress likelihood. The result above reveals a Pseudo R^2 value of 0.3988 which indicates that about 40% of the variation in dependent variable has been explained by all the independent and control variables in the model. This also means that about 60% of the variation in the dependent variable is left unexplained but have been captured in the error term. The model goodness of fit as captured by the Likelihood Ratio (183.46) with the corresponding probability value 0.0000 which shows a 1% statistically significant level reveals that the entire model is fit and can be employed for discussion and policy recommendation. Particularly, the classification table show that out of 166 cases that fell into the group of distressed firms, 137 cases were predicted correctly with 85% sensitivity accuracy while 141 out of 166 cases that fell into the group of healthy firms were predicted correctly and with 83% specificity accuracy. However, we find that the overall accuracy rate is seen to be roughly 84% which suggest that the model is free from any significant bias hence can be employed for interpretation and policy recommendation.

Discussion of Findings

Based on the result obtained from the logistic regression analyses we find that the variable of CEO gender has a significant negative effect on financial distress likelihood of manufacturing firms in Nigeria during the period under investigation. Our result on the variable of CEO gender diversity is in line with the resource dependence theory which assumes that female directors (female CEO) bring

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to the board different perspectives and experience. Existing body of literature documents that female directors are more risk averse hence the likelihood of distress is slim. This finding supports the claim of Mateos de Cabo, Gimeno and Nieto (2012) who argued that risk adverse behaviour of female directors is the main reason for the 'Glass Ceiling' on corporate promotion ladder. The finding also aligns with those of Graham, Harvey and Puri (2013) who find that female CEOs are less likely to have higher leverage ratios compared with their male counterparts so that the risk of financial distress is low. Our result also supports those of Huang and Kisgen (2013) who find that female CEOs are less likely to rely on long-term debt to undertake acquisitions. The authors also noted that female CEOs are likely to exercise stock options early compared with male CEOs suggesting that male CEOs are more overconfident with respect to corporate decisions. However, the findings contradict those of Berger, Kick, and Schaeck (2014), Adams and Funk (2012) who noted that hiring a woman CEO may not lead to more risk-averse decision-making hence the chance of financial distress is eminent.

Based on the result obtained from the financial distress logistic regression analyses we find that the effect of foreign CEO diversity on financial distress likelihood is significantly negative during the period under investigation. According to the Upper Echelon Theory, one notable observable CEO characteristics is nationality. The outcome from this study is seen to align with those of Rahman et al., (2017), Nielsen & Nielsen, (2013), Jalbert et al. (2007) who document a negative relationship between CEO birthplace and leverage ratio (risk), Pan et al. (2018) who find a negative relationship between uncertainty avoidance index (UAI) and spending on mergers and acquisitions, implying that cultural heritage seems to have a noticeable effect on risk behaviour of U.S CEOs, Mourouzidou-Damtsa et al. (2017), Bernile et al., (2017) who finds that the degree to which natural disaster resulted in fatalities seem to affect risk behaviour nonlinearly implying that CEOs that have not seen extreme outcomes of natural disasters are more risk-taking than CEOs that have seen extremes hence CEOs from foreign countries play a significant role in reducing the level of financial distress during the period under consideration.

5. Conclusion and Recommendation

Financial distress is an inevitable phenomenon that has been a crucial topic of corporate finance literature. In general, the consequence of financial distress is negative on social and economic position of any country. Corporate organizations are intermittently faced with governance quality which is been tackled daily to ascertain the organizations wellbeing. Owing to corporate governance crisis rocking the corporate world which often metamorphose into financial crisis and if not carefully handled creates room for financial distress the need to undertake this study becomes very pertinent. Particularly, we note that the findings offered from this study using the Nigerian environment depicts mixed and salient situations where governance mechanism strives. We strongly perceive that the outcome from this study will help all stakeholders keep track of firm business activities, minimize the risk of failure, and make effective decision. Particularly, we profer recommendations that will guide stakeholders operating corporate organizations listed on the floor of the stock exchange market of Nigeria. Generally, we recommend that managers of firms listed on the stock exchange (espectially those within the non-financial) should always make effort to validate the financial health of their company from time to time. Hence in line with the significant outcomes obtained from the empirical analysis we carefully recommend that adopting policies such as "gender quotas" that will allow women act as CEOs' will go a long way to extend the firms' lives span. This ideal is based on our empirical outcome which suggest that women can act as defense mechanisms towards the reduction of risk via enhanced solvency and liquidity which is conducted by concentrating on internal

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investment, and tightening corporate governance. Further, foreigners should be provided with opportunities to serve in coprorate boards and such policies going forward may be subsequently enshrined on the code of corporate governance in Nigeria. This in in view of the empirical finding that such corporate policies will allow for positive influences of different perspectives, skills and knowledge accruing from more traditional backgrounds of foreign directors and all these accounts for better monitoring.

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