Financial Expert CEOs: CEO's Work Experience and Firm's Financial Policies

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We examine whether Chief Executive Officers (CEOs) with previous experience in the financial industry or in a financial role matter for corporate financial policies. We first show that an important fraction (41%) of CEOs are financial expert CEOs. When we look at their firm's financial policies, we find that nonfinancial firms headed by financial expert CEOs hold less cash on average. Furthermore, they are more leveraged and they have a higher propensity than other firms to pay out money to shareholders. These differences are economically meaningful. Regression results indicate that cash holdings are about 12% lower and average leverage ratios are 6% higher (evaluated at the mean). These firms are also 7% more likely to repurchase shares.

We also provide evidence that they are more financially sophisticated. Typical firms use companywide discount rates to evaluate investment projects rather than a project-specific one. This has been called the weighted average cost of capital (WACC) fallacy. We use segment-level investment policy in diversified firms to find that only firms without a financial expert CEO fall into the WACC fallacy trap. We then exploit exogenous changes to business conditions to test whether financial experts react in a way that is consistent with higher levels of financial sophistication. We use the 2003 cuts to dividend and capital gains taxes, known as the "Bush tax cuts," and find that financial experts were more responsive as measured by increases in total payout to shareholders. The tax cuts increased the dollar value of dividends and capital gains after 2003, therefore, increasing payout would be more beneficial to shareholders. We also show that financial expert CEOs are better able to raise external financing, even under tighter credit market conditions, suggesting that they have better access to capital markets. These results are consistent with the idea that financial experts can follow more aggressive financial policies (holding less cash and more debt) because they can access financial markets more easily.

Other Results

We also find

- lower investment-cash flow sensitivity for financial expert CEOs
- no evidence suggesting that financial experts overinvest just because they have better access to financing.
- that newly hired financial expert CEOs are more likely to replace an incumbent chief financial officer (CFO) within the first year of their hire

We also show that financial expertise might come at the expense of having less expertise or skills in other dimensions:

- We find that financial expert CEOs are producing less innovation
- However, we do not find evidence that financial experts invest less in marketing activities, or that they are less efficient in such activities.

Conclusion

Overall our results imply that previous *work experience* of the CEOs, namely, their financial expertise, affects firms' financial policies. In addition, we show that financial expertise seems to come at the cost of other skills relevant to the firm, as suggested by the evidence that financial experts produce less innovation.