

**CAPITAL UNIVERSITY OF SCIENCE AND
TECHNOLOGY, ISLAMABAD**



**Impact of Executives Attributes on Strategic
Financial Decisions: A Comparative Study on
Sharia and Non-Sharia Compliant Firms of UK
and Pakistan**

by

Iram Naz

A thesis submitted in partial fulfillment for the
degree of Doctor of Philosophy

in the

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**Impact of Executives Attributes on Strategic Financial
Decisions: A Comparative Study on Sharia and
Non-Sharia Compliant Firms of UK and Pakistan**

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I learned from my Mother Where there is a will, there is a way. I learned from my Father, Always do the best job, Your reputation is worth more than a quick profit.



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This is to certify that the research work presented in the thesis, entitled “**Impact of Executive Attributes on Strategic Financial Decisions : A comparative Study on Sharia and Non-Sharia Compliant Firms of UK and Pakistan**” was conducted under the supervision of **Dr. Syed Muhammad Amir Shah**. No part of this thesis has been submitted anywhere else for any other degree. This thesis is submitted to the **Department of Management Sciences, Capital University of Science and Technology** in partial fulfillment of the requirements for the degree of Doctor in Philosophy in the field of **Management Sciences**. The open defence of the thesis was conducted on **27 July, 2017**.

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List of Publications

1. Naz, I., Shah, S. M. A., and Kutan, A. M. (2017). Do managers of sharia-compliant firms have distinctive financial styles? *Journal of International Financial Markets, Institutions and Money*, 46, 174-187.
2. Kutan, A. M., Naz, I., and Shah, S. M. A. (2017). Are top managers important for firm performance and idiosyncratic risk? Evidence from sharia vs nonsharia-compliant firms in the UK and Pakistan. *The World Economy*.

Abstract

Top executives/managers are important for success/failure of the organizations because they influence firms operations through financial and non-financial decisions. Literature suggests that managers are not identical and that the idiosyncratic differences among managers exist because of the differences in personal values and cognitive styles, which lead managers to make different decisions mostly in complex situations. Literature provides enough evidence on significant role of managerial style in different corporate policies such as investing, financing, voluntary corporate disclosure and corporate tax avoidance and find significant role of managers styles for these policies. However, the literature is limited in scope with respect to geographic and economic context, the subject matter and nature of business conduct. This study addresses this gap in literature by examining the role of top managers in financial decisions, performance and idiosyncratic risk of sharia and non-sharia compliant firms in Pakistan and the UK. The sample of the study comprises of Pakistani and UK firms. The data period ranges from 1999 to 2014 for Pakistani firms and 2001 to 2014 for UK firms. Following [1], a manager-firm matched panel is constructed, the study tracks individual top managers of sharia-compliant firms across different firms over time. This includes tracking the observed variation in firms financial decisions, the performance and the idiosyncratic risk that can be ascribed to fixed effects of managers, while controlling for observable and unobservable differences across firms. The study also compares the financial decisions, the performance and the risk across sharia and non-sharia firms. Moreover, the differences in the styles of managers who move between sharia and non-sharia firms are also examined. The results of this study shows that the managers exercise significant effect over the financial decisions of the firms, the performance and the idiosyncratic risk of both sharia and non-sharia firms. The decisions of managers who come from non-sharia-compliant firms are significantly different from those who come from sharia-compliant firms. Moreover, the policies of sharia firms with respect to the leverage, the dividend payouts, the working capital, the performance and the idiosyncratic risk differ significantly from those

at non-sharia-compliant firms. The results of study have important policy implications for shareholders who elect the directors, institutional investors who invest massive amounts in the shares of listed companies, and creditors who advance huge loans to large companies. Discerning the differences between the importance of managerial financial styles of top officials in sharia and NSC companies helps them make strategic plans in terms of their financial decisions.

Key words: Executive attributes, Strategic Financial Decisions, Capital Structure, Dividend Payout, Working Capital, Idiosyncratic Risk, Performance, Sharia Compliant firms, Non-Sharia Compliant Firms, Managers Fixed Effects, and Financial Styles.

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Abbreviations

CEO	Chief Executive Officer
CFO	Chief Financial Officer
COO	Chief Operating Officer
SC	Sharia Compliant
NSC	Non-Sharia Compliant
MM	Modigliani and Miller
NPV	Net Present Value
UK	United Kingdom
PLOM	Perth Leadership Outcome Model
FTSE	Financial Times Stock Exchange
ROA	Return on Assets
ROE	Return on Equity
ROS	Return on Sales
PLC	Public Limited Company

Chapter 1

Introduction

One of the most important objectives of business organizations is the maximization of shareholders wealth. This objective, however, is the outcome of certain organizational activities guided by top management through financial and non-financial decisions. Towards the achievement of this objective, therefore, the role of top management, the decisions, and financial outcome become very important. Financial decisions influence the firms financial outcomes and the associated uncertainty caused by both internal and external factors. The performance and value of the organization is inexorably affected by the decisions made by the top managers / executives of a particular organization. Thus different tools are sorted or consulted by them, so as to make the decision-making process effective or beneficial [2]. It has been observed during last five decades that theories involved in formal decision making, model of rational choice has been accepted by the game theorists and expected utility theorist [3]. For many, if not most people, calculation of the output of normative models is considered to be nothing more than managerial decision-making. Moreover, the continuous pursuit by managers in exploring new tools for better comprehension will ultimately lead towards the accomplishment of betterment in decision-making processes.

The decision-making process and research on the subject, including its contributions towards practical life as well as in the field of academia, can be traced back three centuries. As far as contributions are concerned, they include mathematical models to access or estimate the theories of economics, and other areas like

finance or management in practical fields. Subsequently, many fields or areas like cognitive and social science have been affected by the process of decision-making [4]. In the recent past, various decision-making process theories have been found which require an understanding of the multidisciplinary approach. [5] points out that comprehending human acuity and its origin has played a vital role in having a better comprehension of the intricacies of the decision making process.

In academic literature, it is well recognized that human behavior is what influences the decision-making process. Primarily it is the reaction of the human thought process to the peripheral world, encompassing the overall effects of the events vis-à-vis their impact on or significance for decision makers. The merger of mutual philosophies between a specific event and the behavior of the individual towards the happening of that event, is the basic of decision-making [6].

[7] explains that in management, decision-making has two broad approaches: one of these deals with the developments, followed by the implementation of normative rules for the economy and statistics. The other approach relates to what reality is: a descriptive contemplation of the choices, judgments and decisions that people really make. There is a simple difference between theories like Normative and Descriptive. The Normative theory highlights how decisions should be made by someone, whereas the Descriptive theory emphasizes how decisions are actually made. The word should can be taken in many ways as far as the normative theory is concerned. Moreover, it has also been established by researchers that the essential requisites for the rationale of decision-making are described by this theory. Yet another interpretation of normative theory (normative decision theory) is how decisions should be made by someone, which is also called rationality in decision making.

In an organization, strategic decision-making is the main responsibility of the top management team, usually the Chief Executive Officer (CEO) or the Chief Financial Officer (CFO) [8]. A question which arises and needs deliberation is: once a strategic decision is being made by the CEO / CFO of a business firm, are they fully conversant and is it rational? The pivot of the study are the CEOs / CFOs because they play a vital role, while making strategic financial decisions. In

order to address this query, it is necessary first to look at the idiosyncratic styles of the decision-makers, who are normally the top hierarchy – the senior executives. According to the upper echelons theory [9], managers are not identical. This theory suggests that idiosyncratic differences in managers experience are due to differences in the personal values and cognitive styles of each particular individual, which will result in the managers of the firm taking different decisions mostly in complex situations. This theory further suggests that these decision-making preferences will lead to different organizational outcomes.

The prominent view is that top managers are a very important element of corporate practices and policies. Some studies also confirm that differences in managers idiosyncratic styles is reflected in cross-sectional differences in a company's capital structure, dividend pay-out decisions, working capital decisions, idiosyncratic risk and firms performance. Several studies [1, 10, 11, 12] explore the effect of managers style on different corporate policies – such as investing and financing policies, corporate leverage, voluntary corporate disclosure and corporate tax avoidance and they find that managers styles play a significant role in these policies. The question concerning managers financial styles has subsequently sparked considerable debate among researchers [13]. According to [1], top managers of firms are the key ingredient for the determination of corporate policy, and their impact on a company's performance, financing, investing and operating decisions is significant.

Although, economics and finance literature recognizes the role of managerial styles for financial decisions and firm performance, the empirical evidence is not direct. For instance, several studies [1, 10, 13, 14] suggest that managerial styles are related to organizational activities such as operating decisions, performance and share prices. Although it is indirect, there is enough evidence to suggest that managerial styles can influence firms financing decisions, performance and idiosyncratic risk. The literature, however, pays little attention to the direct role played by managers in explaining cross-sectional variation in these matters. In this context, an important question thus arises: whether top executives can in part explain the variations in firms financing decisions, idiosyncratic risk and performance in

addition to other variables such as firm, industry or market factors¹.

1.1 Theoretical Background

Theoretical linkage of decision-making goes back to the decision theories which are generally categorized as either descriptive or normative. A decision theory is related to identifying the need and timing of the decision-making, on the assumption that the decision-maker is acting rationally. The practical application of descriptive theory is known as decision analysis. The normative theories suggest how the decision should be made: however, people can behave irrationally, which violates the assumption of optimality. The concerned area of study, which is seeking to describe what people actually do, is known as the positive or descriptive discipline. Therefore the normative theory relates to creating hypotheses for testing the actual behavior relating to optimal decisions, and these two theories normative and descriptive are closely related. Moreover, in certain other ways there is a possibility that assuming the perfection of such factors as information and rationality can be relaxed, and generate numerous predictions about behavior, new vistas can be opened up for enquiring into and testing the decisions which occur in practical life.

The interest in behavioral decision theory has been increasing in recent decades, and has further led towards the re-evaluation of the requirements for rational decision-making. According to the work of [16] and [17], human behavior is systematic and most of the time it import to depart from expected utility maximization. [18] have proposed the prospect theory, which they say has transformed the empirical study of behavioral economics while giving less prominence to rationality presuppositions. Three consistencies have been found: in actual decision making by human beings, losses which emerged were less than the gains, change in the utility of people was more in focus, and subjective probability is influenced by affixing.

¹Very few researchers appear to have examined the impact of managerial characteristics on the performance and investment of firms. For more detail, see [15]. However, they do not control the firms fixed effect and cannot isolate the managers fixed effect from it.

Moreover, [19] and [20] have suggested that probability maximization is the mathematical equivalent to expected utility maximization; thus they concluded that any unexpected decision will have unexpected consequences which are preferable to uncertain benchmark. This psychological approach suggests that individuals have ambiguous or uncertain objectives or desire levels [21], which may differ from one choice context to another. Thus the focus will be shifted from utility to the uncertain reference point of the individual.

Earlier literature on finance, accounting and economics broadly suggests that idiosyncratic characteristics of non-finance managers play only a minor role in organizations financial decisions on investing and financing, idiosyncratic risk and performance. The theory of neoclassical economics assumes that people behave rationally in their decisions; the rationality assumption, therefore, does not appear to allow the influence of idiosyncratic characteristics on the outcome of decisions [22]. According to agency theory, the role of idiosyncratic styles of individual managers on corporate decision is a very limited one. Several studies (such as [1, 10, 11, 12]) explore the influence of managers style on different corporate policy areas such as investing and financing, corporate leverage, voluntary corporate disclosure and corporate tax avoidance, and they find managers styles play a significant role in relation to these policies.

The Perth Leadership Outcome Model (PLOM) is a model which was developed by [23]. It is different from the preceding models, yet is an extension of the one by [1]. The punchline of this model is that the outcome or end product of the business is directly proportional to or influenced by the personalities of the individual managers. Furthermore, it explains the outcome strictly as per the financial term. It also shows the relationship between the individual(s) and the financial goals which need to be accomplished. These financial characteristics are termed financial styles by the PLOM. Intuitive approach of handling with finance is behavioral phenomena. Top executives can increase the performance or market value of organizations by closely monitoring the financial styles of the managers. Similarly, the strategic financial decisions may be affected by managerial financial

styles, the styles of managers are either aggressive or conservative [1]. These decisions are vital because they help the corporate manager in boosting or maximizing the wealth of the stake holders and minimizing the cost of finance. There are three main categories: long-term financing decisions (capital structure decisions) and short-term financing decisions (working capital decisions and dividend policy decisions) and investing decisions. These decisions ultimately affect the performance of the firm. The main objective of firms is to maximize the wealth of the shareholders, and thus profitability becomes very important towards its achievement. However, profits are always accompanied by uncertainty (risk) caused by both internal and external factors. The type of uncertainty associated with firms internal factors or decisions is referred to as idiosyncratic risk. Corporations generally do not have control over the external environment but can influence idiosyncratic risk through, for example, diversification and increases/decreases in financial and operating leverage. The role of top managers and their financial traits thus become important for both firms profitability and their specific risk. Rationality assumes that decisions are free from emotions or feelings, but financial styles are in fact driven by innate behavior, which may lead to decisions being irrational. Again, a large number of financial decisions are based on projections, which are essentially subjective exercises, and vulnerable to the attitude of the decision-maker. Hence, financial styles can influence even those financial decisions which are seemingly based on cold data. The financial styles of top executives can potentially affect several aspects of corporate decision-making such as capital structure, dividend policy and working capital decisions. The outcome of these decisions is mostly apparent in performance and the risk profile of the firms. The role of financial styles in relation to these areas of corporate decision-making is discussed in the following sections.

The managers decision to finance the assets of a firm is referred to as capital structure or financing decisions. These decisions are very important from the perspective of value maximization. Generally, there are two modes through which a firm can finance its assets: debt or equity. More extensively, there are two options

for the firm to finance its assets: one is external and the other is internal. Internal sources of the funds include retained earnings whereas the external financing options may include the issuance of new shares or debt, or a mixture of both.

Finance literature is replete with studies focusing on the financing mix or the capital structure. Several theories have been proposed to highlight the significance or relevance of capital structure. [24] are among the pioneers who first discussed the capital structure. Although they argued that the value of the firm is not dependent on which financing options are used, their proposition led to a series of discussion on this topic. The proposition put forward by them is known as the irrelevance principle, and popularly known in literature as the MM irrelevance principle or the MM irrelevance theory. This principle suggests that firm value is not dependent on financing choices (capital structure) in a perfect market. The principle stands on very strong assumptions related to the financial markets. These assumptions are, for example, the absence of government taxes and transaction costs, risk free lending/borrowing as well as risk free equity issue, the absence of costs related to agency problems and bankruptcy, and finally, all market participants are equally well informed. In the real world, however, these assumptions may not hold true. For instance, government taxes, bankruptcy costs, information asymmetry and the costs related to agency problems are present in the real markets. All these elements have a real influence on a firms financing choices, therefore the value of a firm does depend on the capital structure.

In response to the MM irrelevance principle, two conventional theories of capital structure have emerged: the tradeoff and the pecking order theories. The tradeoff one proposes that the firms decide on a certain target for their capital mix (namely, debt and equity). This mixture of debt and equity is directed by the tradeoff between cost, which is linked with debt (an example is bankruptcy costs) and the tax shield benefit, which is provided by the interest on debt [25, 26]. Therefore the tradeoff theory suggests that firms strive to achieve a mix of financing options that reduces the cost of capital to the minimum level, the same level at which the value of a firm is maximum. Due to temporary variations, firms may alter

their capital structure, which may cause their leverage to diverge from the target capital mix.

The pecking order of financing options (the pecking order theory) builds its basis on fact that not all the market participants are well informed [27, 28]. It explains the phenomenon that decisions of the management to raise capital through external sources leads the investors to notice that the firms stock is overvalued. So, they offload all the stocks which they have that will lead to a fall in the firms value. To avoid such a situation, firms normally pursue a sequence of financing choices: for instance, they resort to internal financing first, fixed claim borrowing second and new issuance of shares last. [29] proposed a diverse perspective to the capital structure which is known as the market timing theory. They found that it is less costly for managers to raise capital by using an external financing mode because of the overvaluation of the companys stock. So when the price of shares is high in the market compared to their book value, firms go for raising funds through share issuance, and when the price of shares is low compared to their book value, firms may buy back the outstanding stocks. Hence, the historical performance of shares is related to the current capital structure of businesses.

The decisions regarding distribution of income among shareholders in the form of dividends are very important for the development of the corporate financial policy as they can have an effect on the availability of the funds as well as on the cost of capital. The CFO of a company takes decision on dividends and approval is required from the stockholders of the firm. Generally the stockholders of the firm do not use their right to increase the rate of the dividend or ask about the dividend because of their lack of knowledge about the factors that have affected this proposal. Ultimately this decision affects the capital structure and stock price of the company.

Three but contradictory theories of dividend have been identified. Some claim that the value of a firm will increase when it increases the payment of dividends. Another argument is that there is an inverse relationship between high dividend payments and the value of the firm: in other words, they decrease the firms value. According to the third theoretical approach, dividends are irrelevant; therefore

all attempts spent on dividend decisions are useless. These three views reflect the different personalities who take decisions on the dividend. The debate on dividends goes well beyond the relevance or irrelevance of dividends for the firm's value. It extends to investors' preferences, agency problems and the information mechanism. These propositions in the domain of dividend policies further complicate the idea, and dividend related decisions are referred to as the dividend puzzle.

Dividend policy and firm risk are two major concepts in the overall domain of corporate finance, but in literature, dividend policy has an impact on firm risk which has received only slight attention. Nevertheless, risk has now become a very important factor in explaining the well-known effects of value on dividend payout policies [30, 31]. Some research has shown that positive value effects after unanticipated initiations and increases of dividend are well documented [31, 32, 33, 34, 35]. In contrast, other research has shown large but negative value effects after unanticipated omissions of dividends or decreases in the amount of dividends [33, 35, 36, 37]. Since, managerial styles are related to firms' financing decisions, by inference they are likely to affect firms' dividend policy decisions as well.

Conscious decisions regarding the extent to which short term assets (current assets) are being financed by the long term liabilities are vital for the smooth functioning of business operations. The surplus of current assets over current liabilities is known as working capital [38, 39]. The management of working capital refers to the short term and operational financing of assets and adjusting the level of investment in cash, accounts receivable and inventories of the company, which is known as its investment policy. It also refers to managing the accounts payable by the company, which is identified as its financing policy. In this case, there are working capital strategies which are known as aggressive and conservative policies.

Aggressive working capital policy is characterized by higher levels of current liabilities and lower levels of current assets, which result in high levels of profitability and the attachment of high risk to them [40, 41]. In contrast, the conservative policy of working capital means higher levels of current assets and lower levels of current liabilities, which lead to lower profitability and risk [40, 41]. Besides these two extreme approaches, there is an intermediate working capital policy known as

the matching and hedging principle. Under this principle, current liabilities are equal to the current assets [40]

The most important aspect of working capital management is to keep right level of current assets for the needs of daily operations, in order to ensure the smooth functioning of the business and to meet its obligations [42]. The management of working capital is, however, not a simple goal, because the managers have to ensure that the operation of the business is operating both profitably and efficiently. During the process, the levels of current assets and liabilities are likely to diverge, and if such a mismatch happens and the managers fail to deal with it adequately, the resulting imbalance between current liabilities and assets will affect the firms profitability and growth. This mismatch can further bring pressure from creditors and force the firm into bankruptcy. The major concern for managers in the management of working capital is to seek a balance between benefits and the opportunity cost of liquidity, by having a high level of working capital [43, 44]. Risk, return trade off, is ever present in businesses, and risky venture have to offer higher returns. Hence, the higher levels of working capital ensure a lower liquidity risk but also therefore low profitability. In contrast, lower levels of working capital expose firms to a higher risk of liquidity problems but at the same time costs are saved from piling up inventories serves to increased profitability. Similarly, some authors [45, 46] argue that the cash conversion cycle has a negative relationship with profitability and risk adjusted returns; thus it can be said that the performance or output of the firm will show remarkable improvement once a policy is adopted of having a fundamental of aggressive working capital.

The nature and styles of managers play a vital role while deciding the policy for working capital management. When financial managers provide an aggressive policy it means that the level of current liability will increase in order to handle the suitability of current assets. As a result of this action, the risk of short-term liability will increase even though the level of profitability will also increase. On the other hand, if managers want to make a conservative policy for working capital, then as a result the profitability will decrease followed by a lower risk of short term liabilities.

The outcome of financial decisions is mostly revealed in the form of firms performance. The main objective of every manager is to maximize the wealth of shareholders and to increase the value of the firm, which is possible when its financial performance can be achieved. Top executives of the firm can play a vital role in its performance. The role of managerial styles for firms performance is also recognized in literature; however, the evidence is indirect. For example, managerial styles are related to organizational outcomes [1, 10, 11, 13, 14]; managers can impact share prices (market measure of performance) by altering firms dividend policies [47, 48, 49] the quality of the top management team is an important ingredient of firms performance [50] and finally, top managers have a significant impact on a firms financial and operating decisions and on its performance [1].

The risk management decisions are linked to the success or failure of businesses. The maximization of the shareholders wealth is one of the prime objectives of a corporate enterprise. Therefore, profitability becomes very important in relation to its achievement. However, profits are always accompanied by uncertainty (risk) caused by both internal and external factors. The type of uncertainty associated with firms internal factors or decisions is referred to as idiosyncratic risk. Corporations generally do not have control over the external environment but can influence idiosyncratic risk through, for example, diversification, and increases/decreases in financial and operating leverage. The role of top managers and their financial traits thus becomes important for both a firms profitability and its specific risk. With respect to the managers role in relation to idiosyncratic risk, the literature provides some indirect evidence: for example, while dealing with borrowing and investment decisions, managers concern for their reputation may encourage them to pursue overly conservative business strategies [51, 52] if the managers are overconfident they will prefer more debt, which will lead to high idiosyncratic risk [53] the CEOs vision is the most important ingredient for the determination of a firms policy [54, 55] and managers of levered firms tend to select those investments that increase the firms idiosyncratic risk [56]²

²See also [25]

According to [57], if at the beginning of the CEOs tenure the cost of borrowing by the firm increases, then the firm must change its financial policies over time, as a function of these changes in borrowing costs. When a new CEO is hired and at the start of his/her tenure the risk of the firm increases, then it reflects management-related uncertainty, which will lead to increasing the firms idiosyncratic risk. Similarly, [58, 59, 60] find that volatility of a firms stock return increases in relation to the CEO turnover and it continuously declines during the first three years. So the implication of this decline in stock return is that uncertainty about management is major element of firms idiosyncratic risk.

In the existing literature of finance and accounting, the researchers started to study the possible existence and influence of managers specific effect on the financial, operating and investing decisions of the firm [1, 10, 11, 61]. The development in the finance and accounting literature has challenged the traditional theory of economics according to which there is no role of managerial styles, by verifying that managers characteristics do have an influence on various decisions by the firms. According to [1], the managers fixed effects are in fact the managerial styles³.

According to this recent literature of managerial styles, the theory of neoclassical economics suggests that there is no role of managerial styles because all individuals are assumed to be homogenous in the economy. According to this view, all individuals are perfect substitutes for each other, and in extreme cases all are irrelevant in relation to decisions by the firm. According to a less extreme view, managers can be homogenous but the homogeneity is very limited in scope. As suggested by the traditional agency theory, the agents and the managers are different in at least two aspects: the ability and the preferences for the risk. The primary objective of the manager is to maximize the function of utility, which involves aversion to effort and risk. In this regard, the most fundamental case is that of the firms boards of directors. The board of directors, through its monitoring mechanism, ensure that the managers put in the maximum level of effort and take the right actions.

³The pioneers of the manager mobility method are [1], who estimate the fixed effect regression by controlling for all the known determinants of the dependent variables, along with the firm fixed effect. The estimated managers fixed effect is, however, the incremental contribution of the managers styles on the firms decision variables of the interest.

Moreover, business organizations employ compensation contracts as an incentive to align their firms and managers objectives, therefore ensuring that managers are acting as the firms agents and that their personal characteristics are not affecting the decisions [25]⁴

The classical research on economics and finance is consistent with that on strategic management, which determines that all managers are the best substitute for each other. There is one field in literature that emphasizes the process of socialization and selection for someone to become a manager. The stream of literature finds that homogeneity among managers increases when they become the top manager of a large firm [63, 64, 65]⁵

A deviation in the classical view of strategic management occurred, however, when the upper echelons theory [9] was introduced. According to this theory, when an individual makes an ambiguous and difficult decision they are subject to the concept of bounded rationality. This means that current decisions are affected by the past experiences resulting from similar decisions [9, 69, 70]. A considerable amount of research on the implications of the upper echelon theory suggests that organizational decisions are influenced by the characteristics (experiences and values) of the managers [71, 72, 73]. However, the literature has provided mixed evidence about the specific effects of managers on firms decisions.

1.2 Gap Analysis and Research Problem

Although there is enough evidence in the literature to suggest that top managers are important for organizational policies and ultimately the success of organizations, there are limited studies on the direct link between managers financial styles

⁴According to the literature on corporate governance, the discretion of managers to exist and create variation in decisions of the firms when the monitoring of the manager is poor. This literature specifically attributes the variation in the monitoring capabilities of the firm not to idiosyncratic styles of the managers. One exception to this stream of literature is [62]

⁵In addition to this particular stream of literature of strategic management, other streams in the literature of management reach the same conclusion and find that managers are a perfect substitute for each other because of the firms norms and culture [66] and because they copy other managers [67, 68]. The heterogeneity among top managers decreases because they have risen through the ranks and become the top executives through the qualifying mechanism put in place for their selection [63]

and firms financial decisions, risk-taking and performance. From the theoretical perspective, there are two different views. As mentioned, the neoclassical theory of firms assumes that managers are homogeneous and are a perfect substitute for each other. In addition, all managers make the same rational decisions in the same economic situations. According to the neoclassical view, top executives are a key ingredient in strategic decision-making, but these decisions are not influenced by managers individual financial styles [22]. In contrast, the upper echelons theory [9], maintains that managers are different in their decision-making styles, and idiosyncratic differences exist due to different personal values and cognitive styles that lead managers to make different decisions mostly in complex situations. Thus, according to this theory, the decision-making preferences lead to different organizational outcomes. The theory is based on the characteristics of individuals and their judgements and decision-making. According to the literature on their judgements and decision making, three factors that can affect individual decision-making are the person, the environment and the task [74]. Person-related factors refer to individual characteristics such as risk behavior, intrinsic motivation and confidence, which all influence the cognitive processes that leads to decision-making. These personal characteristics are given different names in the literature, such as financial styles [75, 76], managerial styles [77], and managers fixed effects [1, 10].

These studies are, however, limited in scope with respect to geographic and economic context, the subject matter and the nature of business conduct. For example, the studies are conducted in the context of developed countries only (a limitation with respect to geographic and economic context). The economies in developing countries differ substantially from those in developed countries in term of political stability, law and order situations, technological development, and use of information technology, financial structure, income level and education. Therefore, the validation of an economic or financial concept demands its testing in different geographic and economic contexts. Further, the existing literature on managers financial styles ignores the managers impact on dividend policy, working capital decisions, idiosyncratic risk and performance of the firm (a limitation

with respect to subject matter). Since managers influence other areas of decision-making in finance, it can be logically inferred that they also matter for dividend, working capital policies, idiosyncratic risk and performance of the firm.

Moreover, the current literature on managers effects does not account for the philosophy under which business is conducted (a limitation with respect to the nature of business conduct). For example, Sharia-compliant (SC) and non-sharia-compliant (NSC) firms operate under different sets of principles and rules. The term sharia is referred to the Islamic laws which control the different aspects of life of Muslims even the type of investments which are allowed. For example the interest which are considered as Ususry according to Riba rules are prohibited to those investors who follow the sharia. The sharia firms follow the Islamic laws whereas the non-sharia compliant firms do not follow the Islamic laws.

These different business philosophies may have an important bearing on managers styles; yet this aspect has been neglected in the literature on managers styles.

In this context, an important question thus arises: whether the role of top executives can in part explain the variations in firms financing decisions, idiosyncratic risk and performance in addition to the other factors such as firm, industry or market factors. In order to bridge this gap in the literature, the present study considers the possibility that individual top managers are partially responsible for variations in financial decisions, performance and the idiosyncratic risk in their firms.

It has been observed that there has been an increasing trend towards investment in sharia financial products during the last few years. For example, the market for sharia-compliant financial products in the UK has grown by about 15% to 20% in the last two years. According to a recent report, worldwide sharia-compliant assets are worth US2 trillion⁶ The ideology which distinguishes between sharia and non-sharia compliant business is based on the belief that Islamic law should be the source of any decision that firms make, and that in doing so, in Muslim countries Islamic law takes superiority over the rationale of traditional economics whenever there is a conflict between the two. The increasing story of success as far as Islamic

⁶For further details, see [78]

finance is concerned, is being observed by the financial market, which follows a distinctive method of investment that is directly correlated with the norms and ethics of socially responsible investing.

Sharia, Islamic law, is the pivotal factor or the core principle of Islamic finance; this is why Islamic finance has become a legitimate mode of finance. The Holy Book of Muslims, the Quran, is the foundation of all the Islamic laws, which directs all the Muslims as to how they can and should lead their life, in all matters pertaining to their personal as well as collective life style. Islamic finance has a unique feature: it does not allow interest in any form, whether minimal or too much, or floating or fixed, or multiple. To obey the rules of sharia, investments must not involve interest (Riba). Islamic finance is popular worldwide and has a complete financial and economic solution but is still not well organized outside the Muslim world. Lack of fund management and proper institutional setup are some of the challenges hindering its progress. Compared to conventional systems, it has strong financial and institutional networks all over the world. There is now a Dow Jones Islamic Index⁷, which tracks almost 600 companies.

According to [79], Islamic finance has experienced remarkable growth since 9/11 and is now around the whole world. The main feature of financial decisions in sharia compliant firm is Islamic finance. Because of the greater emphasis on religion, for investment in stock a large number of Muslims have started investing in it [80]. Previously, they used to avoid investing in the stock market, as such investment was regarded as gambling, which is forbidden in Islam. However, it has been found that among the most significant clientele of sharia-compliant firms are the religious or sharia conscious investors. As a result, it has been observed that the bulk of these sharia conscious investors, and other investors (institutional)

⁷The introduction of the Dow Jones Islamic Market Index took place in 1999, and happened to be the pioneer in the field of sharia compliant firms. Over 70 catalogues have been registered and have been made part of the most complete fraternity of Islamic Market Indicators like global / regional / individual countries and industries indexes. The most authentic or credible index is the Dow Jones Islamic Market Titans 100 (the indicator of the 100 largest companies, which are considered companionable as per the standards of Sharia) and the Dow Jones Islamic Market Asia / Pacific Titans 25 Index (meaning the 25 largest companies in Asia and the Pacific). The FTSE Sharia Global Equity Index Series is another leading group of indices. They are also known as indicators, for those investing in global equity and in accordance with Islamic rules and laws.

use sharia compliant assets for investment of their capital. It is thus pertinent to mention that these types of clientele have acted as a monitoring device. [81] have noted that the effective monitors turned out to be institutional investors (such as mutual funds). Thus the governance environment in the sharia compliant firms has been found to be much better and much more conducive than those of non-sharia compliant firms.

According to [82], the growth rate of Islamic institutions was 10-15 % per annum all over the globe during the last decade. It has been gaining popularity at such a rapid pace and is represented in over 51 countries [83]. In the UK, in order to have a retail Islamic bank, a bank named the Islamic Bank of Britain was established in 2004, and likewise in 2007 it was launched in the Middle East. Muslims (approximately 1.8 million) are being provided with services through Islamic financial product in accordance with Sharia Law via 21 conventional institutions in the UK.

In order to decide whether a firm falls within the category of sharia compliance or not, two types of screening processes exist: financial screening and sector screening. Through the financial screen, firms which are heavily levered and whose earnings depend upon excessive interest are excluded. According to the criteria of the Dow Jones Islamic index, if the borrowing of the firms exceeds one third of their market capitalization, they are excluded. The companies which earn one third of their income from interest are also excluded and this is the case of most of the conventional banks⁸. In the case of the sector screen, the sectors which are unacceptable for the list of sharia compliant firms are brewing and distilling, production and distribution of alcoholic beverages, production and distribution of pork, gambling and operation of casinos, and media companies whose output includes pornography⁹. Moreover, the Islamic firms usually have pacts or treaties with transparent firms, young or multiple banks and specific industries¹⁰.

Whereas according to sharia advisory board in Pakistan, sharia compliant firms must follow six tests; the business of the firms must be Halal which are dictated

⁸For further details see [84]

⁹For more information see [85]

¹⁰See[86] for more details.

by sharia, the ratio of debt to equity should be less than 37%, the ratio of non-compliant income to total assets must be less than 5%, the ratio of illiquid assets to total assets must be at least 25% and the market per share must be greater than the net illiquid assets per share.

Moreover, several possibilities may exist in the realm of the managerial styles of decision-makers. For example, at one extreme it is possible that CEOs/CFOs with similar styles may act similarly in any economy while at the other extreme it may transpire that even similarity in managerial styles does not necessarily lead to similar decision-making in different economies. A need for studying such situations is not as infrequent as it may appear at first glance, since most companies now operate in a number of different countries, each with its own set of economic circumstances and cultures. This effectively is an uncharted territory where very little, if indeed any, research exists.

This study focuses on the top executives effect on financial decisions, idiosyncratic risk and performance in the context of the sharia-compliant (SC) firms in the UK and Pakistan. In Islamic firms, the managers should act as a trustee of Allah while performing the duties in organizations. They must ensure that all their formulations, plan executions, organizational tasks, leading of workforce and controlling of resources are consistent with Tawhid and specific principles of Islam [87]11). In sharia compliant firms, the role of managers is very important because they are ones who need to ensure that firms policies are in compliance to the sharia. The study focuses on the sharia compliant firms in UK and Pakistan because we want to explore the managerial effects on financial decision, idiosyncratic risk and performance of developed and developing country. The primary objective of the study is to determine whether top executives play a significant role in explaining cross-sectional variation in financing decisions, performance and idiosyncratic risk. The study also investigates whether the managers working in SC firms have distinctive financial styles. Although there are a few studies which investigate the differences in the dividend policies and target capital structure of sharia and non-sharia compliant firms (for instance, [88, 89], they do not address the effect of individual managers specifically their styles on such decisions.

This study aims to address this problem and to bridge the research gap in literature by focusing on the impact of managerial styles on firms financial decisions (on capital structure, working capital and dividend policy), idiosyncratic risk and performance of the firms. Secondly, it examines the difference in the styles of managers who move across non-sharia and sharia complaint firms.

1.3 Research Questions

Based on the research problem, this study aims to answer the following research questions:

Research Question 1

Do top executives play a significant role in explaining cross-sectional variations in the financial decisions (capital structure, dividend policy and working capital) of sharia-compliant firms in two different economies, namely Pakistan and the UK?

Research Question 2

Are the differences in the performance of sharia-compliant firms are attributable to top executives in the contexts of Pakistan and the UK?

Research Question 3

Are the cross-sectional variations in idiosyncratic risk of the sharia-compliant firms are explained by the existence of top executives?

Research Question 4

Are the financial decisions, idiosyncratic risk and performance for the managers who moved from NSC firms to SC firms are different from those who moved from SC to SC firms?

Research Question 5

Do observable characteristics of the CEO have significant influence on the firms financial decisions, idiosyncratic risk and performance?

1.4 Research Objectives for This Study

Objectives of the study are as follows:

Research objective 1

To examine the role of top executives in financial decisions (capital structure, dividend policy and working capital) of sharia-compliant firms in Pakistan and the UK.

Research objective 2

To explore whether the differences in the performance of sharia-compliant firms are explained by the existence of top executives in Pakistan and the UK.

Research objective 3

To explore whether the top executives play a significant role in explaining cross-sectional variations in idiosyncratic risk in sharia-compliant firms in two different economies, namely Pakistan and the UK.

Research objective 4

To explore whether financial decisions, idiosyncratic risk and performance for the managers who moved from NSC firms to SC firms are different from those who moved from SC to SC firms.

Research objective 5

To explore whether the observable characteristics of the CEO have significant influence on the firms financial decisions, idiosyncratic risk and performance.

1.5 Contribution of the study

This study contributes to finance literature in three different ways. First, the study explores the impact of managerial fixed effects on financial decisions, risk

and performance of sharia compliant firms. While studying managerial fixed effect, the existing literature has ignored the sharia compliant firms. The role managerial characteristics (referred to as managerial financial styles or managerial fixed effects) is important in context of sharia firms because the operations of sharia compliant firms are different from those of non-sharia compliant firms i.e. the sharia compliant firms follow the standard laws which are guided by Quran and Islamic laws. Second, the study examines the role of managerial fixed effects in important areas of financial decision making i.e. capital structure, dividend policy and working capital management, idiosyncratic risk and firm performance. Although, there are few studies that examine the role of managerial fixed effects on firms capital structure and performance, they ignore other related areas like dividend policy, working capital and idiosyncratic risk. This study also contributes to the literature by addressing the developing country like Pakistan. The existing literature has exclusively focused the the developed country like USA. Since, the economies in developed countries are in many ways different from those in developing countries, one may expect the managers to behave differently across firms operating in different nations. This study explores the role of managerial effect for firms in a developing country i.e. Pakistan, and compares these results with firms in a developed country i.e. UK.

The study also examines the difference in managers who switch to or from sharia and non-sharia-compliant firms, to explain firms, financial decisions, idiosyncratic risk and performance. The existing literature has discussed a similar methodology as used in this study on the different aspects of the firms in context of USA but the literature ignores the other developed countries and the sharia business firm. So, the last contribution of the study is that it applies the proposed methodology to sharia firms in the UK and Pakistan.

The study adopts the methodology of [1], by constructing a set of firm-manager matching panel data in which it is possible to identify the top managers of SC firms across various firms (whether SC or NSC firms). After accounting for the observable and unobservable heterogeneity, the study identifies the observable differences in firms financing decisions that are attributable to managers fixed effects. It also

determines whether the managers who move from non-sharia to sharia-complaint firms and those who move from sharia to shariacompliant firms are similar in their styles. The results of the study show that the managers exert a significant influence over leveraging, the dividend policy, and working capital decisions. The decisions of managers who move from non-sharia to sharia-compliant firms are significantly different. Moreover, the leverage, dividend pay-out and working capital for sharia compliant firms are significantly different from those of non-sharia compliant firms.

Idiosyncratic risk has been calculated by using the methodology of [90], while return on assets, and return on equity and stock returns, have been used as performance measures. The results of this study show that top managers play a statistically significant and economically important incremental role in explaining idiosyncratic risk and performance. Moreover, for managers who move from non-sharia to sharia-compliant firms there is a statistically significant difference between them in terms of the individual effects on a firms idiosyncratic risk and performance.

1.6 Organization of the Study

The rest of the study is organized as follows: Chapter 2 provides the literature review and theoretical framework; Chapter 3 presents a brief discussion on the data and empirical methodology; Chapter 4 describes the data analysis; and Chapter 5 discusses the conclusion and policy implications.

Chapter 2

Literature Review

According to Neoclassical economic theory, the top executives of firms are homogeneous and selfless inputs into the production process of firms, and the managers are considered as perfect substitute of each other. Therefore, there is no role of different idiosyncratic styles of managers which can influence corporate outcomes [22]. However, [1], develop an novel design that separates the managers fixed effects from firm fixed effects. They show that managers matter in financing, investment and operational decision and performance of the firms, but the magnitude of managers influence varies widely; managers effect are generally more for high profile strategic decisions like acquisitions and smaller for other decisions. [91] suggest that it may be possible that managers styles change over time, and thus the within-manager variation in style could be different as much as the across-manager variation.

2.1 Financing Decisions

Capital structure decision is the most important financing decision. Capital structure decision has various theories. The birth of modern capital structure theories are started in 1958 when Modigliani and Miller came up with new propositions. MM introduced the proposition of irrelevancy in their well-known work of cost of capital, corporation finance and theory of investment. They used cross section

equations and took data of 43 electric utility companies from 1947-1948 whereas, in 1953, it was found out by 42 oil companies that whether the cost of capital influenced by the choice of capital structure. The principle of MM is based on few expectations / assumptions such as no taxes, no transaction cost, lending and borrowing at risk free rate, firm issue risk free debt and equity, no bankruptcy cost, no agency cost and symmetry of information. They argued that if company wants to grow the firm value it can be only possible on the left hand side of balance sheet by investing in assets that have positive NPV. The right hand side of balance sheet which is also called the financing decision does not contribute towards the firm value. According to MM if firm take debt or debt is equal to zero, thus effect on the value of firms is nil (no effect). According to them, value of firms and cost of capital are not dependent on capital structure. For all degrees of leverage the value of firm and cost of capital are remain same. Usage of low expense debt finance is offset by the overall increase in the cost of capital, and thus the average cost of capital remain constant regardless of the capital structure used by the firm. Five years later, [92] presented corporate taxed in their earlier model by relaxing first assumption of no taxes. According to them the firms can obtained optimal capital structure when they finance 100 percent through debt and have tax shield of using debt. With the introduction of tax, the value of levered firm become higher. Later which was revealed as correction model. According to some of the researchers Modigliani and Miller are unable to explain the practical application of this theory to individuals firms.

In the later studies, most of the researchers criticized hypothesis of MM. According to [93] overall cost of the capital was affected by the level of financial leverage; that will affect the return on shareholder equity and value of firm. MM hypothesis was also criticized and it was also argued, there are numerous factors such as market imperfectness, existence of transactional cost, institution restrictions and preference of investors for present income over future that affect the capital structure of firm are ignored by the MM¹.

¹For more detail see [94, 95]

Literature of the capital structure reflects, that four, but conflicting theories have been developed such as trade off theory, agency cost theory, signalling hypothesis and pecking order theory. Recent two models which were developed, basically to explain the choice of capital structure, these models are constructed on input and output market interactions and also based on market timing. The theories are explanation as under: The origin of trade off theory was started from the discussion over the theorem of MM. when they added the tax into the original irrelevance proposition of MM, a benefit of tax is observed that provide tax shield to the firms.

Static trade off theory explain that the performance of the firm is influenced by its target debt ratio, which is reflected in the choice of firms capital structure [96]. This theory also explain that the firm can obtain the optimal target capital structure by balancing the benefit from the tax shield of debt financing and cost that is related to the leverage such as bankruptcy and distress, while holding the assets of firms and investment constant. According to [27] the firm who adopt this theory they are regarded as setting the target debt ratio and progressively / gradually moving to achieve it. This theory suggest that the firms which are profitable have high target for debt ratio (conflict with pecking order hypothesis which propose that the higher profit earning firm have less debt). The firm with high profit confirm that they can get high tax shield from debt, low bankruptcys probability and high investment, and high debt ratio will be required for all these.

The dynamic version of trade off theory is known as dynamic trade off theory which is disseminated by [97] and they stated that the relationship between profitability and leverage is negative. The argument for this is that, the firms actively collect the earnings and losses then deviate their debt ration from target as long as the cost of adjusting debt ratio is more than the cost of having sub optimal capital structure. So, the firms that were highly profitable in the past are likely to have less gearing [96]. This theory suggests that the firms issues equity or debt to maintain its target debt ratio. Some of the studies shows that the firms basically manage target debt ratio² .

²For more detail see [98, 99, 100]

In literature, agency cost is the most important theory, which was established by [25]. According to them the debt is the most important factor which create conflict between the managers and shareholders. They argue that the probability distribution of cash flow provided by the firm is depend on the ownership structure and this may be used to explain the optimal capital structure. Whereas [101] contend that debt can reduce the agency cost by increasing the possibility of bankruptcy and that provide a managerial discipline. On the other hand [102] find that variation in earning will increase the cost of bankruptcy this will in turn reduce the agency cost so the companies tend to use less debt.

Ryan and [8] provided the theoretical summary of agency cost. According to them there are two sets / groups of agencies problem, which are confronted by the firms i.e. conflict between shareholders and manager; between shareholders and bond holders. In case of conflict between managers and shareholder, managers mostly take fewer debt so as to evade total risk that comprises loss of job, reputation and wealth of the firm. Whereas on the other hand too much spending by the managers may lost the cash flow of the firm which could be used for other activities which benefits shareholders.

The conflict between the shareholder and bondholders are the other area of agency cost whereby shareholder maximize the wealth at the expense of bondholders. The bondholder can limit this action of shareholder by drafting a bond covenants.

According to Pecking order theory the firms show a different preferences for using internal finance (retained earnings or additional liquid assets) over external finance. If firm doesnt have adequate internal finance to finance investment prospects /opportunities then firm must go for external finance. If firm decides to go for external financing, there are different source of financing. The firm must go for that source which has minimum additional cost of asymmetric information. According to pecking order theory the firm must go for internal generated funds first, followed by low risk debt financing and share financing respectively.

[103] introduced a theory and highlighted; relationship between leverage and profitability is positive, which is in contradiction of the pecking order theory that suggests that relationship between leverage and profitability is negative. Main

concept of signalling theory is that the choice of capital structure give a signal to the outside investors about the insider information. According to Ross, the managers of the firms are insider and they know true distribution of the firms returns whereas the investors dont. The managers are more comfortable with the equity as compare to debt because high debt will result in taking the firm towards bankruptcy, resultantly, managers will lose jobs. Ibid in view, if the manager take more debt in capital mix of firm, this gives a signal of higher cash flow. High level of debt will be considered as the sign of high quality by the investors thus the predictable profitability will be positive as compared to leverage.

According to the previous researches managerial traits / managerial styles develop trade-off theory which allow personal physiognomies / characteristics / features to have influence on capital structure decisions. Managerial trait theory, is not considered as part of theories traditional capital structure. Though, it highlights that both, magnitude and combination of managerial biases, determines the preference concerning debt and equity [104].

The decisions that are related to the financing aspect are very important in the field of corporate finance. The financing decisions are based upon the composition of relative percentage of different sources of funding that include equity, debt etc. the categorization of these sources can be classified as internal or external. In standard finance theory major researches are based upon the assumption of rationality; but modern studies in finance claim that the decision on capital structure, funding decision and strategic choices diverge from traditional model of neoclassical [105, 106]. These studies become source to bring the attention of practitioners and scholars to find the behaviors of managers that affect the decision they took and they diverge from the traditional finances assumptions. Effects of different managerial traits on corporate financing behavior has remained the focus of several studies. For instance, according to [107] managers whose behaviors are either optimistic or overconfident, they may choice to finance according to pecking order theory. [108] explore that the managers who have behavior of growth perception they overvalue the growth of future earnings which are generated by their firm and according to them financing through external sources are extremely costly. [61]

find that the Chief Executives Officers who have behavior of risk taking they may start more mergers and acquisitions. Idiosyncratic styles are individual behaviors that allow them to make different decisions.

[109] explain the underpricing of IPO underpricing with bias of anchoring and mental accounting. According to them there are two criteria through which the managers of firm can estimate the success of new stocks when issue new shares. According to the first criteria the increase in shares may come from the variation between the closing price of first trading day and the average price of the price range, in this they take average price as an anchor. Second definite loss is the result of underpricing. If the raise in the price is more than the loss in underpricing, typically managers of the firm regard it as the IPO success. The theory which is provided by the [109] they explain finding of experiment and they found that the when underpricing is more uttered if the price of offering of the issue is more than the price range. According to [107] under such circumstances top executives of the tolerate a larger loss of underpricing.

According to [110] there is relationship exists between pecking order theory and optimism that affect the capital structure. He find that extreme overconfidence leads top executive to assume that the stocks of their company are undervalued. [111] finds this relationship by using questionnaire; he discovers that the managers of the most firms believe that the stocks of their firm are undervalued. Although this survey was completed at the end of the last century during the period of internet boom. He used the term overconfidence. Most of the managers feel shy to issue new share and they go for internal financing. The consequence of this is that the managers of the firm try to avoid debt financing when the operating cash flow of firm is low. So the overconfident CEO/CFO reluctant to issue new share is prove that managers who are overconfident use high debt [112]. [113] find investors and managers both act irrationally in the field of corporate behavioral finance. They find that when the stock of the firm overvalued they start issue new shares, the performance of these stocks is low in the long run that motivate speculations ultimately. Initially Public Offering and Seasonal Equity Offerings generate lower returns as compare to the aggregate market [114, 115].

[116] examine when company issue new share it reduce the cost of capital at the cost of new investors. It assumed that intentionally the wealth is transfer from new shareholders to existing. Moreover [117] confirmed this finding in their study in which they took date from 1933 to 1949 of US market and find that the stocks that are issued to new shareholders underperform in comparison with the market. [118] show that most of the private investors purchased issued stocks for the SEOs. According to them these investors are attracted by the rise in price of shares which usually before the issuance of the shares. They claim that investors assume that the price of the share will further increase after issuance. Whereas [115] find that this belief, however, in most of the cases turns out to be incorrect.

[119] find that when the markets of shares goes down company repurchase their own shares. [120] complete a survey to get an idea for fund raising whether firms go for debt or share issuance. He finds the interest rate level affect both decisions. [121] find that there is negative relationship between short term and long term interest for the newly issued shares. According to [122] the results are same of their survey based study, their study show that most of the time top executives of the firms believe that interest rate as measure that is use to decide whether company issue shares or not.

The financial decisions which are taken by the manager are depending upon the market condition; it is assumed that past valuation of the share affect the capital structure of the company. [29] study that there is negative relationship between the average past price to book ratio of the company. They also find that there is negative association between equity and debt. They find that financing decision of the firms based on the over and under valuation of the share prices. However [123] claims that average price to book value of the firms stock explain the association between equity and debt because the information related to the growth of firm is contain in price to book ratio, which ultimately will affect the target capital structure of the firms. [15] find that the managers who are optimistic they prefer internal financing rather than go for new share issuance or debt. They find that there is positive correlation between optimistic behavior of the managers and self-financing. [124, 125, 126] find the same results. They find that there is positive

association between uncertainty and optimistic behavior of the managers. This uncertainty is arise just because of the available information that can influence the decisions of the managers. According to [127]the meaning of uncertainty is risk aversion that push the managers to think conservatively and take action accordingly. Moreover reject any decision that could alter the current situations that may include entrance of new shareholders.

[128] study that the loss averse managers try to avoid the bad case situations. These kind of managers use risk management tools to reduce the variation of the cash flow but they also try to avoid the bad situations that can affect bankruptcy risk or may stop firm to take that investment which increase profit for the firm. These kind of managers stay away from the external financing and choose internal financing. [125] find that important determinant of ownership structure is the variations in the securities. Loss averse managers have knowledge about the stock returns volatility of the company they avoid external financing to keep away from loss. They find that company must issue the stock when market overestimate the companys stock.

In psychology the literature suggests that top executives of the firms are most of the time likely to show overconfident. [129] find that CEOs who start their career in the period of recession they take conventional capital structure decisions, for instance they select low debt and internal over external growth. [130] highlights that the overestimation of probability of success and presence of the biased financial decisions has positive association between them. The managers who are overconfident mostly they overestimate their personal skills and take the decisions which are inconsistent with the firms characteristics. Most of the time they underrate the bankruptcy risk of the firm and think that they can control it. These opinion lead them to take more debt and increase the level of debt of the company. [131] claim that the overconfident managers mostly underrate the chances of the financial distress and as a consequence they take high debt than optimal level, that will cause the higher cost of capital and chances of bankruptcy will be higher. The CEOs who are overconfident they prefer debt over equity financing. [132] considers

that overconfidence of CEO and financial distress has positive relations with each other. Managers underrate the chances of bankruptcy that leads to higher debt. Most of the studies recognized the presence of the behavioral biases and their effect on the corporate policies and decisions. This study hypothesizes that managerial financial styles can affect the capital structure decisions of firms.

2.2 Dividend Policy Decision

The term of dividend policy is defined by [133] according to them the policy of dividend payout that managers follow when they decide the size and pattern of cash distribution to shareholders over time. To explain dividend policy there are various theories developed and those theories are explain below: Dividend irrelevance theory is first theory of dividend policy which is given by [134]. Arguments given by them were based on the assumption; perfect market and rational investors, in which there is hardly any difference between capital gain and taxes, when share are traded there is no flotation and transaction cost incurred, whereas all investors have equal and free access to the information, there is no conflict of interest between shareholders and managers, and all the participants in the markets are the price taker, [134] maintain that dividend policy is irrelevant. The theory describes that in perfect market dividend policy has no influenced on either cost of capital or the price of firms shares. The wealth of shareholder is not affected by the decision of dividend. Hence, they would be indifferent about the payment that could be in form of capital gain or dividend. According to the [134] the shareholders wealth is affected by the profit or income that is generated by the investment decision which is made by the firm not by how much it distribute income to its shareholders. Moreover, they argued that distribution of firms income is determined by firms investment decision and firms earning power. They stated that the dividend policy decision that firm decide to adopt has impact on the current share price, but not on the total return to shareholders when investment is known.

The other theory of dividend policy was proposed as a result of fallout from irrelevant theory of [134] and this theory is known as the Signaling hypothesis or

Information Asymmetry Theory. According to [135, 136] the signaling hypothesis is what happens when investors can conclude the information about the future earnings of the firm through the signal that is coming from the announcement of dividend that could be in form of stability of or change on dividends. Thus, according to this hypothesis the managers of firms must have possession on the private information about the future prospect of firm, and have incentives to take this information to the market. Secondly, the signals should be true; for example a firm should not be able to send a wrong information to the market regarding increase in dividend when firm future prospect is poor. So that market should depend upon the signals that are generated by the firms manager. If all these conditions hold then the market should react favorably to the announcement of the increased dividends and otherwise react unfavorably.

The one of the main argument on Agency cost theory of dividend policy is that, just because of the imperfect nature of the managers, their interest may be different from the interest of the shareholders. They may be engaged themselves in such activities that consume too much capital or over investing in managerially rewards, but those may be unprofitable activities. This may lead to higher agency cost that may be bear by the shareholders. Therefore, the agency cost theory suggest that the payment of dividend lessen the agency problems between shareholders and managers, by reducing the funds that are available to the managers [137, 138, 139]. According to [138] the payment of dividend will reduce significantly NPV projects. According to him firm with excessive cash flow give managers more flexibility to use funds in a way that benefits themselves rather than shareholders. He also examined that when firm extract excess cash from the control of management through payment of dividend that will also avoid investment in negative NPV of poor projects.

Another theory that is related to dividend payment is Clientele Effect theory. According to this theory the capital market is not perfect, so the investors face different dividend and tax on capital gain and they therefore have different after tax valuation for the same assets. According to the hypothesis of [134] these kind of differences lead to the development of the term what we called dividend

Clienteles, in which the investors have tax based preferences on shares that are different only in their policies of dividend. Al-Malkawi et al. (2010) examine that these clienteles are used to attract by the firms that follow dividend policies that best suit their particular need and situation.

Likewise, firm may try to attract different clienteles by using their specific dividend policy. For instance, the firms that are operating in high growth industries that usually pay low or no dividends. Whereas on the other hand the firms who want to attract more clientele (who prefer dividend) they pay huge amount of their income as a dividend.

The other theory is tax effect hypothesis according to this theory low ratio of dividend payout will lower the cost of capital and increase the price of share in market. In other words low dividend payout ratio will contribute to maximization of shareholders wealth. [135] find that the basis of this argument is on the assumption that the dividend are taxed at higher rate as compare to the capital gain. Moreover, dividend are taxed instantly, whereas tax on capital gain is deferred until the share is sold actually. This kind of tax advantage of capital gain over dividend influence the investors who have favorable tax treatment on capital gain to prefer those companies who retain most of their earnings instead of paying them as a dividend. Moreover the investors are willing to pay a premium for low payout companies. Hence, the low ratio of dividend payout will lower the cost of equity that will increase the share price.

Another theory which explain the policy of dividend is Bird In Hand theory. According to this theory, because of the uncertainty and imperfection, the valuation of dividend is different from the retained earnings and capital gains. According to this theory, the investors prefer the Bird in Hand of cash dividend rather than two in the bush of future capital gain [135]. When the firm increase dividend payment that may be linked with increases in value of firm. For instance, when the dividend is high it will reduce the uncertainty about the future cash flows, a high payout ratio will reduce the cost of capital and therefore the share price will increase. According to the Bird in hand theory the high dividend payout ratio will increase the value of firm.

The last theory of dividend policy is Catering theory, this theory suggest that the tendency to pay dividend is depend upon the dividend premium (or discount) in share price. This theory was developed by [140] in order to relax the market efficiency as defense against the irrelevance theory of [134]. The crux of catering theory is that the managers give investor what they currently want. There are three main ingredient of this theory. Firstly, it suggests a source of uninformed investors demand for firms that pay cash dividend. Secondly, limits of arbitrage allow this demand to influence current stock price. Lastly, managers of the firms rationally evaluate the short term benefit of catering to the current mispricing against the long run cost and then make the decision of dividend payment.

Role of behavioral biases for corporate decisions has been the topic of hot debate in finance literature. Several biases such as optimism, overconfidence and loss aversion are shown to have an effect on companies dividend policies. For example, [141] suggest that managerial optimism is positively related to the use of internal financing. Optimism typically leads managers to prefer internal financing over other financing options because they consider their companys stock to be undervalued by the market. Hence, the optimistic managers end up paying less dividend. Similarly, [142] while studying the optimism of the managers find that optimistic leaders prefer to investment in which the involvement of the leader is more prominent. Such leaders tend to pay less dividend and use the cash flows to finance the projects.

On the other hand, [143] contend that managers prone to overconfidence use more debt to invest the large projects. Overconfidence about expected growth leads them to rely more on external financing options. The tendency to invest in heavy projects typically involves small dividend payments. Overconfidence is also supposed to be related to the risk of bankruptcy. For example [130] argue that the probability of overestimation is higher for overconfident managers, they normally overestimate their investing skills and opt for the investing/financing decisions in contradiction to the firms characteristics. Such contradictions are likely to increase the probability of bankruptcy. Similarly, [132] also show that financial distress is positively related to the overconfidence of the CEOs. The overconfident managers

unduly assume to have control over the business environment which leads them to be less careful about financial distress and use more debt. Thus, the overconfident managers are likely to follow more liberal dividend policy.

Loss aversion is yet another bias which works contrary to the optimism and overconfidence. [128] contend that the loss aversion makes the managers to avoid the unpleasant situations while ignoring the positive side. Loss averse managers may try everything to reduce the cash flow fluctuations, during the efforts they may deprive the company of profitable investment opportunities. The debt affects the credit rating negatively, a loss averse managers avoids the debt financing and uses internal sources and as a result, ends up paying less dividend.

Following the industry norms (getting affected by the industry) may also contribute to the financial decisions. In behavioral finance, the herding behavior is more appropriate term for the industry effects. Earlier studies such as [144, 145] highlight the role of herding behavior for business related decisions. Although, the study of [144] considers different aspects of the herding behavior in different settings, [145] relate the herding behavior to the dividends. Herding in their case refers to copying the actions of the market leader. In their study, they use dividend data on 43 different industries and conclude that herding behavior with respect to dividend policy exists in those industries. The evidence on industry effects for dividend policy is also provided by [146]. For example, [146] argues that firms in a mature industry are more likely to pay dividend than the firms in growth industries. Some other studies related to industry effects on the dividend policy include [133, 145, 147, 148].

For example, [148] find different dividend patterns and different set of factors influencing the dividend policy for more and less regulated industries, however, [139, 149] argue that dividend policy may not depend on the classification of industry. They contend that the variation in dividends across the industries may only be due to the size of the firms. Similarly, [150] find no evidence of relationship between dividend announcements and the intra industry information; they rather argue that dividend initiation is firm specific event which does not depend on what happens in the industry. In light of above discussion, this study hypothesizes

that being the innate behavioral characteristics, the managers financial styles or managers fixed effects are likely to explain the variation in dividend policies across different firms.

2.3 Working Capital Decisions

The primary objective of the firm is to maximize the wealth of shareholders. Firms are operate according to the problems and opportunities. The managers of the firm is mainly depend upon the trade credit policy, bank financing, contribution of personal finance, lase finance and operating finance. The options for financing are limited for the firms and this problem is faced by the large companies [151, 152, 153, 154]. The one of the most important financial problem faced by the firms is the distribution of current assets and current liabilities which are the most important element of Net working Capital Management. The main cause of failure of a firm is poor control management of working capital. It is the responsibility of manager to change the level of working capital.

According to [155] the role of working capital management is very important in determining the success or failure of a firm, because it influence performance of the firm. The success of the organization depend upon the ability of managers to effectively manage the components of working capital [156]. The managers may accept an aggressive or a conservative working capital management policy to achieve the organizational objectives.

Conventionally, the literature of financial management emphasized on the study of long term financial recourses where as various studies have analyzed the topics that are related to financial decisions such as capital structure, investment decisions, dividend and value of firm. hence, the short term investment of the firm whose life is less than one year in the form of current assets that are also represent a major share of the total assets on the balance sheet of the firm. This fall in the area of working capital management.

The area of working capital management is very important because its affect the risk of firm, profitability and value of the firm [44]. Investment in the working

capital is comprise of the balance between profitability and risk because the decision of investment leads to increase the profitability of the firm which prone to increase risk and vice versa.

According to [157] working capital management efficiency is very vital for any organization as this study discussed earlier that more than half of the total assets are current assets. Working capital management efficiency also increase the cash flow of the firms which in turn increase the growth opportunities for the firm and return to the shareholders. The importance of the working capital management is not a new phenomenon in the literature of finance. According to the [158] W.T. Grant which is a nationwide chain of the departmental stores was bankrupt because of the deficit in the operating cash flow in the eight of the last ten years of its corporate life. [159] study that the working capital management is very important for the survival of the firm. The firms who never give due consideration to their working capital management cannot survive for long period of time.

The management of fixed assets is matter of capital budgeting whereas the working capital management is a continuous process which involves control and flow of financial resources that circulate in the firm in one form or the other. [160] discuss the individual items of working capital, according to them if the estimation of firm is perfect then the firm can hold enough cash to make payments, adequate inventories for making the production and requirement of sales and the amount of account receivable as per the optimal credit policy. When firm hold optimal level of these individual current assets it will lead to maximization of profit for the firm. Though, if the firm increase these current assets from above the optimal level it will not increase the profit of the firm. As a results the rate of returns on investment falls. On the other hand according to them if investment of firm in current assets fall from a certain level, it may lead to an inability for firm to pay bills on time and it may also result on shortage of inventory that affect the production activities. It may also lead to loss of sales due to restrictive credit policy by the firm.

According to [161]the area of short term financing particularly working capital management has given very less attention in contrast to long term investment.

The area of working capital management is very important for the growth of firm and for improvement in profit of the firm. Moreover [162] discussed that the one of the main cause of firm failure is deficiency in the planning and control of working capital management. [163] explain that the primary objective of every manager is to keep working capital flowing and use cash flow to generate profits.

The literature has ignore the role of top executives in explaining the cross sectional variation in working capital decision of sharia compliant firms. The hypothesis of this study that the managerial styles are likely to explain the variation in working capital management across different firms.

2.4 Idiosyncratic Risk

Idiosyncratic risk³ which is also known as firm risk affect the performance of the firm. Mangers of firm significantly affect the firm risk [164] because they take high risky projects which have high but volatile returns. The volatility in idiosyncratic risk of firm affect the policy makers planning to forecast and plan their cash flows [165]. According to the literature the managerial ownership play important role in firms risk. When the managers of firm dont have large shares they indulge in risky projects. In case the executives of the firm also own shares and they prefer to take that projects that are in the best interest of all investors [166]. According to [52] some managers avoid risky projects just to cater their career and sometimes those risky projects could have potentially increased the value of firm. Whereas [167] estimate that there is negative relationship between firms risk and managerial ownership. The role of managers in firms risk is very important.

According to traditional economic theory, the characteristics of managers have not play any role in decision making. Therefore, there are several recent papers which provided different empirical evidence. [1] explain the role of managers idiosyncratic styles on corporate decisions of the firm. On the other hand [15] create a measure of overconfidence, which is based upon the tendency of top executives to exercise option and find greater investment cash flow sensitivity in firms who have

³It is also known as idiosyncratic risk which is unique to a certain assets or company.

overconfident top executives. Whereas [122] use psychometric tests to oversee the executives of firms, show that their traits such as risk aversion, impatience and overconfidence are linked to the policies of corporation.

Different studies have showed that the identity of the shareholders of the firms are very important. According to [168] the insiders of public held firms hold a considerable share of the firm. In cross country analysis, they discover that in the countries where investors protection is high, there are low level of insider ownership. Whereas [169] find that intuitional ownership can lead to more effective corporate governance.

Risk attitude of individuals are very important part of theory of finance and economics. They explained the phenomena such as insurance markets, premium of risk in assets pricing and option contract in executive compensation, among others. The researchers have studies intensively attitude of risk of students in lab settings⁴. Though, the little attention has been paid to the risk attitude of corporate executives. Corporate executives are very important component of the firm and they are responsible for the high impact decisions.

Since the important job of an executives to make decision under risk and uncertainty. The decision of the top executives have a big impact on the companys performance and employees, it is observe that the decision making under risk is highly relevant. Most of the researchers use indirect approach for the decision making of the top executives of the firm⁵. Particularly it is very difficult to find willingness of executives to participate in scientific research, most of the literature in finance focus on the relationship between the observable characteristics of top executives on performance of the firm.

In the literature of behavioral finance, the personal characteristics of top executives such as demographic traits and observable behavior are often used as proxies for their cognitive styles, attitude of risk taking and knowledge base, so there is no need to bring together the actual executives. Moreover, these proxies are used to explain the corporate decisions or outcome of the stock exchange to show how

⁴For more detail [170]

⁵For more detail see [61, 171, 172]

much the top executives of the firm influence the firm⁶. Although this area of research is uncover and it leave many questions unanswered. The top executives of the firms make their own risk assessment and bring these assessment to the boardroom when they make a final decision.

CEO of the firms are assumed to the most entrepreneurial board member whereas the CFO of the firm serve as Bean Counter [174, 175] and the non-executives directors of the firms act as some sort of discipline. This proposes that the CEO of the firm as compare to other top executives has highest appetite for the risk and other non-executives and CFO are assumed to be more attentive to balance the CEO.

According to [61] the personal characteristics of the CEO such as optimism and overconfidence have the expected relationship with the corporate policies such as leverage and other corporate choices. Whereas the CEOs risk tolerance and patience are negatively linked to the portion of their salary and total packages of compensation. Whereas [176] find that the decisions of the firms are made in team and the influence of CEO and CFOs risk taking attitude on company is different. The proxies which they have used to explain the relationship between the risk preferences of CEO and CFO are depend upon the structure of risk seeking incentives and policies of companies. For the CFO who follow relatively low risk financial management, they explore significantly lower short term debt and higher accrual policies.

According to [172] there is positive relationship between the success and risk taking attitude of the individuals. The individuals who are reluctant to take risk are not likely to reach at the top. They also find that failed risky decisions hinder the career path. Moreover, when the rate of success is high for executives, then they are more willing to take more business risk and they pursue more feelings as compare to less successful executives. With the passage of time and with rising age the willingness to take business risk and sensation decreases. [131] collect statements from CFOs to measure the overconfidence of CFO. The proxy which they used for overconfidence is to ask CFOs about the future market return within

⁶For more detail see [141, 173]

an interval of 80% confidence. The interval will narrow for CFOs who are too much confident about their predictions. They also find that overconfident CFO use lower discount rate to value cash flow, they invest more and acquire more other firms, pay less dividends and more likely to repurchase shares and long term to short term debt ratio is high.

[177] take together the different aspect of literature, they all have use some proxies to predict the behavior of top executives. They also consider the well cited researches on the behavioral consistency theory that is the concept that the individuals tend to show consistent behavior across different circumstances. Moreover, they state to a set of papers that determine the association between the personal characteristics of top executives and non-financial outcomes. In their empirical work they exhibit that the behavior of CEOs in personal life can be used to describe the financial behavior in corporation they manage. In the survey of [178] the idea of behavioral consistency can be shown. They have used different questions about the willingness to take risk and correlation of their behavior in different domains, as well as willingness of executives to take bets in an experimental validation of the question.

From empirical perspective, literature provides some indirect evidence on managers role for idiosyncratic risk, for example, while dealing with borrowing and investment decisions, managers concern for reputation encourages them to pursue overly conservative business strategies [51, 52] if the managers are over confident they will prefer more debt that will lead to high idiosyncratic risk [53] CEO vision is the most important ingredient for the determination of firm policy [54, 55] and managers of levered firms tend to select those investments that increase the firms idiosyncratic risk [56].

In the above discussion, this study hypothesizes that being the innate behavioral characteristics, the managers financial styles or managers fixed effects are likely to explain the variation in idiosyncratic risk across different firms.

2.5 Performance of the firm

Previous researches have studied behavior of the CEOs/CFOs and focused on what kind of effect behavior has on the corporate performance. But the previous researches have mainly focused on CEOs they have ignored the effect of CFOs. According to [176] CFOs significantly influence the firms financial policies. The top executives of the firms are very important ingredient for the financing decisions of the firms. According to [12] top executives have very important role within the company and they are important factor not only for the corporate policies but also for the corporate performance.

Most of the previous studies focused predominantly on the CEOs and how their decision and behavior influence corporate performance. However, recent researches have started to pay attention to the role of CFOs within a firm and their implication for corporate policies and performance.

[179] study how the education of top executives affect the performance of the firm. But they find no evidence in this study. They also find that the CEOs with MBA degree or law degree dont perform better than CEOs without graduate degree. They influence negatively in the performance of the firm.

Similarly the role of managerial styles for firm performance is also recognized in literature, however, the evidence is indirect. For example, managerial styles are related to organizational outcomes [1, 10, 11, 14, 180] managers can impact share prices (market measure of performance) by altering firms dividend policies [47, 48, 49] the quality of top management team is an important ingredient of firms performance. The firm with higher management quality are described by the large level of investment and high growth in investment. The relationship between management quality and value of firm performance is stronger [50]; and, management style is significantly related to the managers fixed effect in firms performance and that top managers have a significantly important impact on the firms financial, operating decisions and performance [1]. Therefore, the hypothesis of the study is that the managers styles are likely to explain the variation in performance of the firms across different firms.

2.6 Managers Financial Styles

From theoretical perspective role of managerial styles is as old as upper echelon theory (Hambrick and Mason, 1984). However from empirical perspective [1] the first study that investigate the role of managerial styles on the firms financial, operating decisions and performance.

Other researchers also find evidence of managers fixed effect on leverage choice (Frank and Goyal (2007), compensation levels [61], tax avoidance [10, 11] and variability in performance [181] however, these studies are conducted in US context and deal with congenital firms decisions.

[13] confirm the finding of previous researches that manager is not only chosen by board based upon their styles, but their style play an important role in firm strategic decisions. So this suggests that general direction taken by the firms should primarily reflect economics and governance consideration at the level of firm or board. However the selection of top executive manager is very crucial decision because its provide a lens into objective of the firm, and any mistakes in the process of picking a leader or top executive have essential effects on the trajectory of firms policies. They also investigate whether styles are fixed innate characteristics that can be inferred from previous managerial experience and find that it is a possibility that, rather than being fixed innate characteristics, styles that are useful in one environment may developed by working in a similar previous environment. They only study the firms as a whole without separating sharia compliant firms and non-sharia compliant firm. The decisions of both firms are totally different. The manager who came from non-sharia complaint firm to sharia compliant firm he/she has very limited choice for debt. This study capture this side. According to [14], if other differences across firms are adequately controlled then the observed variations in accounting accruals can logically be assigned to the fixed effects of firms managers. They argue that the fixed effects of managers are key to explaining the differences in payables/receivables across the firms. The authors further isolate the fixed effects of CFOs from those of CEOs and discover that in terms of influence on accruals, both CEOs and CFOs are same. However, with

respect earnings, the CFOs are more influential than CEOs. [10] study influence of idiosyncratic styles of manager on voluntary disclosure choices of the firm and find that managers exercise significantly important influence over five attributes of earnings management forecast i.e., precision forecast, frequency forecast, new conveyed by forecast, bias and accuracy forecast. They study career function, age cohort, military experience, MBA degree and legal degree influence the disclosure styles of manager, according to them managers who are promoted from MBA and legal career track, born before World War II and those who have military experience develop disclosure styles displaying certain conservative characteristics. They select the sample from one developed economy.

Some relevant studies which focus on the role/importance of top executive/managers are reviewed in this section. From theoretical perspective, an earlier evidence regarding the role of executives/managers comes from neoclassical theory of the firms which assumes that managers are homogenous and they are perfect substitute of each other and all managers make the same rational decisions in same economic situations. According to this view, top executives are key ingredient of strategic decision making, but these decisions are not influence by his/her individual financial styles [22].

On the other hand, upper echelons theory [9] highlights that managers are different in their decision making. The idiosyncratic differences exist due to different personal values and cognitive styles that lead managers to make different decisions mostly in complex situations. Thus the decision making preferences lead to different organizational outcomes. Foundations of this theory are based on individual characteristics and, judgement and decision making⁷. According to judgement and decision making literature, three factors that can affect the individual decision making include person, environment and task [74]. Person related factors refers to individual characteristics such as risk behavior, intrinsic motivation and confidence which influence the cognitive processes that leads to decision making.

⁷The literature of psychology classifies the characteristics of cognitive into cognitive styles, cognitive abilities and cognitive strategies [182, 183, 183]. All these three types of cognitive characteristics affect the decisions.

These personal characteristics are given different names in literature for example financial styles [75, 76], managerial styles [77], managers fixed effects [1, 10].

From empirical perspective, literature provides some indirect evidence on managers role for idiosyncratic risk, for example, while dealing with borrowing and investment decisions, managers concern for reputation encourages them to pursue overly conservative business strategies [51, 52] if the managers are over confident they will prefer more debt that will lead to high idiosyncratic risk [53]; CEO vision is the most important ingredient for the determination of firm policy [54, 55]; and managers of levered firms tend to select those investments that increase the firms idiosyncratic risk [56].

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[184] study the importance of top executives for shareholders by identifying firm/executive separations and calculate the abnormal returns around the separations. They find that average ability of managers who resign for a similar position at another firm is higher than that of manager due suddenly. Similarly, [185] study the reaction of market to the sudden death of top executives and find that reaction of market is correlated with status of founder and decision making responsibilities⁸

[1] explore the effect of managers styles on firms strategic decisions: for instance, investing policy (capital expenditure, acquisition etc.), financing policy (interest

⁸For more detail see [186, 187]

coverage, dividend policy decision, etc.) and organizing policy (expense, Research and Development, diversification etc.). The results of their study show that managerial styles have an impact which explains the variation in some of these policy decisions, but their effect on acquisition decisions is greater. [1] also state that managers styles are systematically linked with the personal characteristics of the managers, such as managers who were born before World War II and managers who hold an MBA degree. Many researchers have expanded on the work of [1]. For instance, [61] find that managerial styles have influenced managers compensation, and the component of managerial styles linked with compensation is associated with the managerial styles of corporate decisions.

The accounting and finance literature shows that many studies have adopted the [1] method of managers movement to distinguish the impact of managers characteristics on the selection of accounting practices [10, 11, 188, 189, 190]⁹. [10] study the impact of managerial styles on voluntary disclosure. Their study is based on the managers whose last position was that of Chief Executive Officer, Chief Financial Officer, or others. According to them, the managers who have a military background or who were born before World War II have conservative disclosure styles. [11], on the other hand, study the impact of managerial styles on tax avoidance. They found that there is no systematic relationship between the biographical characteristics of managers and a firms tax avoidance. According to them, the difference exists because the managers do not directly take part in tax avoidance activities; rather, they set the tone at the top. According to [190], the personal characteristics of the CFO may affect decisions related to accounting issues, however, the styles of CFOs are not related to apparent features of managers such as age, gender or career track. Keeping the research gap and objectives of this study in perspective, this study tests the hypothesis that the top manager are important for firms financial decisions, idiosyncratic risk and performance of the firms.

⁹All these studies have adopted the same methodology, but the basic research questions that they study are different.

2.7 Islamic Finance and Sharia Complaint Firms

In Islamic finance literature, there are some excellent studies which address different aspects of sharia business. However, they do not discuss the role of top executive for decision making (see, among others, [191, 192, 193, 194]). In context of corporate financial decision of sharia compliant firms, the literature is in its infancy. However, there are some studies which take up such issues as leverage [166, 195], dividend pay-out [88], risk management, performance [196, 196], stock returns [197], Corporate governance [198] and Islamic modes of financing such as Sukuk and Islamic equity funds [196, 199?] of sharia versus non-sharia firms. For example, [88] examine the difference between dividend policy of sharia compliant firms and dividend policy of non-sharia compliant firms in the MENA region during the period of 2005-2009. Their study shows that dividend pay-out ratio of sharia compliant firms is not only higher but they also have higher likelihood to pay dividend as compare to non-sharia compliant firms. According to them due to financial characteristics (low leverage, low account receivables, and low cash and interest bearing securities) of sharia compliant firms they can pay higher dividend than non-sharia compliant firms.

Similarly,[80, 200] find that the firms with low leverage, low account receivables have higher chance to pay dividend. Their studies however, do not show the role of managers fixed effect in explaining the variation in dividend pay-out decision. On the other hand, [89] examine target capital structure and speed of adjustment and determinants of target capital structure of sharia complaint firms of Malaysia. They find that in sharia compliant firm target capital structure exists, and there are certain firms and country level determinants that significantly affect the capital structure of Sharia compliant firms of Malaysia. According to them the magnitude of speed of adjustment suggests a rapid adjustment towards the target capital structure that support the existence of dynamic trade off theory. Managers are one of the most important ingredients of capital structure decisions. This study does not show the role of managers in capital structure decisions. They also focus on one economy, but this study focuses on two entirely different economies Pakistan (developing economy) and United Kingdom (developed economy).

[201] examine the performance of mutual funds of the Islamic and conventional portfolio and they found that on average returns of Islamic portfolio is slightly less than conventional counterpart. Their results also revealed that there is statistically significant difference between the standard deviation of the portfolio, indicating that the Islamic portfolio is riskier than the conventional portfolio.

This study address these shortcomings by studying the impact of managers styles on the corporate decisions of the Sharia compliant firms in context of Pakistan and UK. The primary objective of the study is to determine whether top executives play significant important role in explaining cross sectional variation in financing decisions. The study explores whether the managers working in sharia compliant firms have distinctive financial styles. Although there few studies which investigate the difference in dividend policies and target capital structure of sharia and non-sharia compliant firms i.e. [88, 89]. However, these studies do not address the effect of individual managers specifically their styles on these decisions.

Many researchers examines the decision making characteristics of managers and top executives and study the impact on the financial profitability of the firm. According to [129] characteristics of the managers affect the performance of the company. Recently the most researches show the consistency of financial styles of managers between corporate financial and personal choices on the issue of corporate and personal leverage. The researchers find the relationship between idiosyncratic styles and financial outcomes. It reveals that personal behavioral characteristics of top executives are at least partially predictive of the financial outcomes of their company [177].

Overall there is enough evidence to suggest that managerial styles can influence firms performance and idiosyncratic risk. The literature, however, pays little attention to the direct role played by managers in explaining cross-sectional variation in firms performance and idiosyncratic risk in context of sharia compliant firm. In order to bridge this gap in literature, the study considers the possibility that individual top managers are partially responsible for variation in performance and idiosyncratic risk of the firm. The study focuses on the top executives effect on

idiosyncratic risk and performance in context of the sharia compliant firms in UK and Pakistan.

2.8 Theoretical Framework

According to Neoclassical economic theory top executives of firms are homogeneous and selfless inputs into the production process of firms. So, managers are considered as perfect substitute of each other. Therefore, there is no role of different idiosyncratic styles of managers which can influence corporate outcomes [22]. In strategic management literature, two streams of researches claim that managers are interchangeable. The first stream takes external control perspective and proposes that organizational and environmental constraints like ingrained culture, norms and values limit the choices of managers [202], the other stream considers socialization and selection process through which the experience of top executives growing through the corporate ranks that limits heterogeneity [64] and according to [63], these kinds of mechanisms generate a group of individuals who can be interchangeable and occupy same positions in different organizations and possess same orientations and disposition. For instance, in Fortune 1000 most of the CEOs are white males who have college degrees and most of them are from elite institutions [203?]. Most of the research in strategic management has proved that the influence of idiosyncratic styles of managers is limited [64, 65, 202].

In contrast, there are few studies in economics and finance which show that idiosyncratic styles of managers may influence the firm's corporate policies and performance and other decisions of the firms. According to upper echelon theory individual managers matter for firm policies and decisions [1, 9] considered to be the pioneers of this idea, who explored that individual managers matter for firm economic performance. According to them heterogeneity in firm financing and investing practices can significantly be explained by the presence of managers' fixed effect. [204] points out that some decisions are calculable such as inventory and credit decisions. Sometime complex but in ambiguous situations, managers often face multiple and frequently incompatible goals and they have to operate within

bounds of rationality, within these bounds idiosyncratic values and experience may influence their choices.

According to [14], if other differences across firms are adequately controlled then the observed variations in accounting accruals can logically be assigned to the fixed effects of firms managers. They argue that the fixed effects of managers are key to explaining the differences in payables/receivables across the firms. The authors further isolate the fixed effects of CFOs from those of CEOs and discover that in terms of influence on accruals, both CEOs and CFOs are same. However, with respect earnings, the CFOs are more influential than CEOs. [10] study influence of idiosyncratic styles of manager on voluntary disclosure choices of the firm and find that managers exercise significantly important influence over five attributes of earnings management forecast i.e., precision forecast, frequency forecast, new conveyed by forecast, bias and accuracy forecast. They study career function, age cohort, military experience, MBA degree and legal degree influence the disclosure styles of manager, according to them managers who are promoted from MBA and legal career track, born before World War II and those who have military experience develop disclosure styles displaying certain conservative characteristics. The growing literature on the role of managers fixed effects for the decision making, and the existing gap with respect to managers fixed effects and financial decisions of sharia compliant firms form the basis of motivation to investigate if the managers are indeed important for financial decisions of sharia compliant firms.

The study is based upon the upper echelon theory which discuss that the managers are different in their decision making and the differences are due to their personal values and cognitive styles. So the model of this study is based on this theory.

Chapter 3

Research Methodology

The main objective of this study is to analyze the impact of managerial styles on financial decisions (i.e. capital structure decision, working capital decision and dividend policy decisions), idiosyncratic risk and performance of the sharia and non-sharia compliant firms in UK and Pakistan. The study also examines the difference in managers styles who move across non-sharia and sharia complaint firms. In other words, this study analyses whether top executives play significant important role in explaining cross sectional variation in financing decisions, idiosyncratic risk and performance. Following sections provide detailed discussion on choice and construction of sample, construction of empirical model and measurement of the variables.

3.1 Sample and Data

The choice of sample for this study is based on the limitations of current literature as highlighted in Section 1.2. These limitations are with respect to (i) geographic and economic context, (ii) the subject matter, and (iii) the nature of business conduct. Consequently, the sample of the study consists of Sharia-compliant (SC) and non-sharia-compliant (NSC) firms from Pakistan and UK. The choice of SC and NSC firms address a limitation in the literature with respect to the nature of business conduct (the philosophy under which business is conducted). Moreover, the

choice of Pakistan and UK addresses a limitation with respect to geographic and economic context (i.e. most of the studies are conducted in context of developed countries only). Moreover, several possibilities may exist in the realm of managerial styles of decision makers. For example, on the one extreme it is possible that CEOs/CFOs with similar styles may act similarly in any economy while on the other extreme it may transpire that even similarity in managerial styles does not necessarily lead to similar decision making in different economies. A need for studying such situations is not as infrequent as it may appear at first glance since most companies now operate in a number of different countries, each with its own set of economic circumstances and cultures. This effectively is an uncharted territory where very little, if indeed any, research exists. The development of sharia compliant business is discussed in detail in the following section.

During past several years, there has been increase in the investments in sharia financial products. For example the market for sharia compliant financial products in UK grew at about 15% to 20% in last two years. According to recent report, worldwide sharia compliant assets are worth US2 trillion. The ideology which distinguishes between sharia and non-sharia compliant business is based on belief that the Islamic law should be the source of any decision that firms make and in doing so, Islamic law should take superiority over the rationale of traditional economics whenever there is conflict between the two. The increasing story of success as far as the Islamic finance is concerned, are being observed by the financial market; which follow inimitable / distinctive form / method of investment that are directly correlated with the norms / ethics of socially responsible investing. Islamic finance is popular world over and has a complete financial and economic solution but still not well organized outside the Muslim world. Lack of fund management and proper institutional setup are some of the challenges hindering its way. Compared to conventional system, it has strong financial and institutional network all over the world. There is now a Dow Jones Islamic Index, which tracks almost 600 companies.

According to [79], Islamic finance has experienced remarkable growth, since 9 11; around the whole world financial market. The main feature / the key stone in

the decision making loop, of any firm is Islamic finance. Because of the greater emphasis in the religion, for investment in the stock; Muslims in large majority have started investing in it [80]. Previously, they used to avoid investing in stock market, being considered, such investment as gamble / betting; which is forbidden in Islam. It has been found affirmative that one of the most significant members / clientele of sharia-compliant firms are the religious / sharia conscious investors. Resultantly, it has been observed that bulk of these religious / sharia conscious investors, and other investors (institutional); used sharia compliant assets for investment of their capitals. It is thus pertinent to mention that these types of clientele has acted as monitoring device.

[81] has noted that the effective monitors turned out to be the institutional investor (such as mutual fund). Thus the governance environment found / observed in the sharia compliant firms was much better and much more conducive than those of non-sharia compliant firms. Similarly, [82] shows that the growth rate of Islamic institutions are 10-15 percent per annum all over the globe during the last decade. It has been getting popularity at such a rapid pace and is represented in over 51 countries today [83]. In UK , in order to have a retail Islamic bank; a bank named before Islamic Bank of Britain was established in 2004, and likewise in 2007 it was launched in the Middle East. Muslims (approximately 1.8 Millions) are being provided services through Islamic financial in accordance with the Sharia Law via 21 conventional institutions in UK.

3.1.1 Construction of Sample

The study adopts [1] longitudinal design that tracks managers over time and it requires that manager should work for at least two employing firms, with at least three years at each firm so that its possible for manager to imprint his/her styles. the objective of the study is to examine incremental role of top executive in explaining cross sectional variations in strategic financial decision (capital structure decision, working capital decision and dividend policy decision), idiosyncratic risk and performance of the sharia and non-sharia compliant firms therefore our sample consists of both sharia compliant and non-sharia firms from Pakistan and UK.

To our knowledge, this effect has not been studied and compared for two entirely different economies¹.

Sample of sharia firms has been obtained from Dow Jones Islamic Index (for UK) and KMI-30 Index (for Pakistan). Firm level data for UK firms have been collected from OSIRIS database over a period of 2001 to 2014. For Pakistani firms, data has been extracted from Balance Sheet Analysis (published by State Bank of Pakistan) over the period of 1999 to 2014. Main focus of analysis of this study is on three financial decisions (Capital Structure, Dividend Policy and Working Capital Decision), idiosyncratic risk and performance of the firm.

Information on CEOs/CFOs have been extracted from the database Whos Who and Who Was Who. The study restricts to the subset of the sharia firms for which at least one top managers can be observed in at least two firms whether (sharia compliant or non-sharia compliant) for minimum of three years². The resulting sample contains about 42 (out of which 25 are sharia compliant and rest are non-sharia compliant firms) companies from Pakistan and 132 companies (out of which 85 are sharia compliant firms and 47 are non-sharia compliant firms) from UK. 42 managers from Pakistan and 87 from UK can be observed in two different firms. The average length of stay in a firm for UK and Pakistani manager is a little over 6 and 5 years respectively. The study do not consider firms from financial service and utilities industry to preserve the consistency of results. The study does not consider the financial and utilities industries because the balance sheets and income statements of these industries are totally different which may affect the results of the study.

Sample of Pakistani firms show that 6 CEOs moved from sharia to sharia compliant firms whereas same number of CEOs moved from non-sharia to sharia compliant firms. In case of CFOs, there are 7 CFOs who move from sharia to sharia complaint firms and 10 CFOs switched from non-sharia compliant firm. In UK sample, 10

¹Un-tabulated results show financial decision significantly different across UK and Pakistani firms. The coefficients on dummy variable for all decisions are highly significant. The results are as follow: leverage 0.648 (p<0.0001), dividend policy -3.98(p<0.0001) and working capital decision 0.2219(p=0.006), idiosyncratic risk 0.0113983 (p<0.0001), stock prices -2.255(p<0.0001) ROA 0.09004(p=0.05) and ROE 0.087956(p=0.0478).

²The requirement of three years stay ensures that managers have enough time to imprint their styles in a given company.

CEOs moved from sharia to sharia complaint firm and 22 CEOs moved from non-sharia to sharia compliant firm. There are 15 CFOs who switched to sharia firms from sharia compliant firms and 25 CFOs from non-sharia compliant firms. The study do not consider the managers who move from Sharia to Non- sharia compliant firm because the focus of this study is only sharia compliant firms.

3.1.2 Empirical Model

To estimate the contribution of manager-specific effects in explaining the variation in financial decisions, firms performance and idiosyncratic risk, the study follows the methodology proposed by [1]. Following equations have been developed to achieve the objectives.

$$y_{it} = \alpha_t + \gamma_i + \beta X_{it} + \epsilon_{it} \quad (3.1)$$

$$y_{it} = \alpha_t + \gamma_i + \beta X_{it} + \lambda_{CEO} + \epsilon_{it} \quad (3.2)$$

$$y_{it} = \alpha_t + \gamma_i + \beta X_{it} + \lambda_{CEO} + \lambda_{CFO} + \epsilon_{it} \quad (3.3)$$

$$y_{it} = \alpha_t + \gamma_i + \beta X_{it} + \lambda_{CEO} + \lambda_{CFO} + \lambda_{Others} + \epsilon_{it} \quad (3.4)$$

Where y_{it} stands for the firms financial decisions such as capital structure, working capita decision and dividend policy decision, performance and idiosyncratic risk in each year, α_t are year fixed effect, i are firm fixed effects, X_{it} represents vector of time varying firm level characteristics and ϵ_{it} is random error term. $\lambda_{CEO}, \lambda_{CFO}$ and λ_{others} are variables of interest that represent incremental fixed effects of individual manager on firms financial strategic decisions, performance and idiosyncratic risk. λ_{CEO} represents fixed effects for the group of managers who are CEOs in the last position the study observes, λ_{CFO} shows fixed effects for the group of managers who are CFO in last position and λ_{others} are the fixed effects of manager who are neither CEO nor CFO but they are on top positions like Chief Operating Officers(COO). In order to account for serial correlation while estimating these equations, the error terms are allowed to cluster at firm level.

Equation (3.1) is estimated as the standard equation, where all the firm level control variables, and firm and time fixed effects are included. Equation (3.1) allows us to observe the variation in the dependent variable attributable to firm level control variables, and firm and time fixed effects. The CEOs, CFOs and other managers fixed effects are included consecutively in equation (3.2), (3.3) and (3.4). These models allows us to observe if the managers are important towards explaining the variation in the strategic financial decision, idiosyncratic risk and performance once the firm and time related fixed effects are controlled.

If managers have significant important role in strategic financial decisions, idiosyncratic risk, and performance of the firm, the study expects significant values of coefficients on managers fixed effects. From equation (3.2), (3.3) and (3.4) it is evident that estimation of manager fixed effects is only possible if the manager moves to another firm through period of the study. However, when managers do not leave the firm during the period of the study, then firm fixed effects and the managers fixed effects are perfectly co-linear and cannot be isolated. In order to separate the manager fixed effects from firm fixed effects, the firm must have at least one manager who has switched the firm.

3.2 Discussion of the Variables

3.2.1 Derivation and Calculation of Idiosyncratic Risk

In this section the study reproduces the methodology used by [90] to estimate the measure of volatility without estimating covariance or betas. They decompose the market return of the typical stocks in three components: the market wide returns, residuals of industry and firm specific residuals. On the basis of this decomposition of return, [90] create a time series measure of volatility of the three measures for a typical firm. the main objective of [90] is to find volatility measures that sum the total volatility of return of a firm, without having to take record of covariance and without calculating betas of firms and industry. In this subsection the study will explain how they achieve such a representation of volatility.

Industries are represented by a subscript of i whereas an individual firm is denoted by j . The simple excess return of firm j that belong to industry i in time period t is represented by R_{jit} . Lets assume that W_{jit} is the weights of firm j in industry i . The methodology of [90] is valid for any random weighing scheme provided that they calculate the market returns using the same weights; in this application they used the weights of market value. The industry excess return i at time period t is given by $R_{it} = \sum_{j \in i} W_{jit} R_{jit}$. Industries are aggregated correspondingly. In the total market the industry i weight are denoted by w_{it} , and the market excess return is $R_{mt} = \sum_i W_{it} R_{it}$. The next step is to decompose the return of firm and industry into three components. [90] first write down the decomposition that is based on Capital Assets Pricing Model, moreover they modify it for empirical implementation. The implication of CAPM is that, they set intercepts equal to zero in the following equations:

$$R_{it} = \beta_{im} R_{mt} + \varepsilon_{it} \tag{3.5}$$

For the returns of industry and

$$R_{jit} = \beta_{ji} R_{it} + \eta_{it} = \beta_{ji} \beta_{im} R_{ji} + \beta_{ji} \varepsilon_{it} + \eta_{jit} \tag{3.6}$$

For the return of individual firm ³ β_{im} in Equation (3.5) denote the beta of industry i with respect to the market return m , and is the industry specific residuals. Similarly, in Equation 3.6 represents the beta of firm j in industry i with respect to its industry, and is the residuals of firm, is orthogonal by construction to the returns of industry R_{it} ; it is also assumed that it is also orthogonal to the components R_{mt} and . Moreover, they also assumed that the beta of firm j with respect to the return of markets that is β_{jim} that satisfies . The sum of the weighted betas is equal to one.

³[90] use the market model. They never impose the restriction of the CAPM, and allow intercept free α_i and α_{jii} in equation (i) and (ii). Therefore, the main objective of their is to avoid the calculation of firm specific parameters; rather than the well-known empirical deficiencies of the CAPM, they feel that the zero intercept restriction is reasonable in this context.

$$\sum_i W_{it}\beta_{im} = 1, \sum_j \epsilon_i W_{jit}\beta_{ji} = 1 \quad (3.7)$$

The decomposition of CAPM in Equations (3.5) and (3.6) guarantee that various components of return of firm are orthogonal to one another. So it is permit that simple decomposition of variance in which all covariance terms are zero:

$$Var(R_{it}) = \beta_{im}^2 Var(R_{mt}) + Var(\epsilon_{it}) \quad (3.8)$$

$$Var(R_{jit}) = \beta_{jm}^2 Var(R_{mt}) + \beta_{ji}^2 Var(\epsilon_{it}) + Var(\eta_{it}) \quad (3.9)$$

There are problem with this decomposition, that is, it needs the knowledge of betas of firms that are difficult to estimate and that may be unstable over time. So, [90] work with the most simplified model that does not need any information regarding betas. They also show that the decomposition of the variance just like to Equations (3.8) and (3.9) on an aggregate level.

For that, they consider the following simplified decomposition of industry return that drop the beta coefficient of industry im from equation (3.6):

$$R_{it} = R_{mt} + \epsilon_{it} \quad (3.10)$$

In Equation (3.10), define the difference between the market return R_{mt} and industry return R_{it} . According to [90] the Equation (3.10) is refer to as a market adjusted return model as compare to the market model of Equation (3.6).

When they compare equation (3.6) and (3.8), then

$$\epsilon_{it} = \epsilon_{it} + (\beta_{im} - 1)R_{it} \quad (3.11)$$

In equation (3.11) the residuals of market adjusted return model is equal to residuals of CAPM model from equation (iv) but only if when beta of industry is beta if industry is equal to one and market return is equal to zero.

The main drawback of the decomposition of equation (3.10) is that R_{mt} and ϵ_{it} are not orthogonal, so one cannot avoid the covariance between them. To compute the variance of the yield of industry return:

$$Var(R_{it}) = Var(R_{im}) + Var(\epsilon_{it}) + 2Cov(R_{mt}, \epsilon_{it}) \quad (3.12)$$

$$Var(R_{it}) = Var(R_{im}) + Var(\epsilon_{it}) + 2(\beta_{im} - 1)Var(R_{mt}) \quad (3.13)$$

Where they once again take account the term of covariance and introduce the variance decomposition of the industry beta.

Hence, the variance of an individual industry return contain the covariance term, that is the weighted average of the variance across industries that is free from the individual covariance:

$$\sum_i W_{it} Var(R_{it}) = Var(R_{mt}) + \sum_i W_{it} Var(\epsilon_{it}) = \sigma_{mt}^2 + \sigma_{\epsilon t}^2 \quad (3.14)$$

In equation (3.13) $\sigma_{mt}^2 = Var(R_{mt})$ and $\sigma_{\epsilon t}^2 = \sum_i W_{it} Var(\epsilon_{it})$. The terms that involve betas are aggregate out because of from equation (3.8) $\sum_i W_{it} \beta_{im} = 1$. So, ϵ_{it} residuals from equation (3.10) can be used to construct a measure of average industry level volatility that does not need any calculation of betas. The interpretation of weighted average $\sum_i W_{it} Var(R_{it})$ is the expected volatility of randomly drawn industry (whereas the probability of drawing industry i equal to the weights W_{it}).

For individual firm return they proceed in same fashion. Consider a firm return decomposition that drop β_{ij} from equation (3.6):

$$R_{jit} = R_{it} + \eta_{jit} \quad (3.15)$$

Where the definition of η_{jit} as:

$$\eta_{jit} = \bar{\eta}_{jit} + (\beta_{ji} - 1)R_{it} \quad (3.16)$$

The variance of firm return is

$$Var(R_{jit}) = Var(R_{it}) + Var(\eta_{jit}) + 2Cov(R_{it}, \eta_{jit}) \quad (3.17)$$

$$Var(R_{it}) = Var(\eta_{jit}) + 2(\beta_{ji} - 1)Var(R_{it}) \quad (3.18)$$

Therefore the weighted average of firm variance in industry i is:

$$\sum_{j \in i} W_{jit} Var(R_{jit}) = Var(R_{it}) + \sigma_{\eta it}^2 \quad (3.19)$$

Where $\sigma_{\eta it}^2 = \sum_{j \in i} W_{jit} Var(\eta_{jit})$ is the weighted average of the firm level volatility in industry i . using equation (ix) calculate the weighted average across industries, yields again a beta free variance decomposition:

$$\sum_i W_{it} \sum_{j \in i} Var(R_{jit}) = \sum_i W_{it} Var(R_{it}) + \sum_i W_{it} \sum_i W_{jit} Var(\eta_{jit}) \quad (3.20)$$

$$\sum_i W_{it} \sum_{j \in i} Var(R_{jit}) = Var(R_{mt}) + \sum_i W_{it} Var(\varepsilon_{it}) + \sum_i W_{it} \sigma_{\mu it}^2 = \sigma_{mt}^2 + \sigma_{\varepsilon t}^2 + \sigma_{\eta t}^2 \quad (3.21)$$

Where W_{it} and W_{jit} are the weights of industry and firm respectively. The study uses equation (3.8) to estimate the firm specific volatility or firms idiosyncratic risk, the study uses market adjusted return model as a starting point⁴.

To estimate the firm specific volatilities, the study begun by summing up the squares of the residuals of equation (3.7):

$$\sigma_{\eta jit}^2 = \sum_{set} \eta_{jis}^2 \quad (3.22)$$

⁴For more detail see [90]

Where s represent months and t represents years. To obtain the firms idiosyncratic risk, then multiply the weighted average within every industry is with its respective residuals:

$$\sigma_{jit}^2 = \sum_{j \in t} W_{jit} \sigma_{\eta jit}^2 \quad (3.23)$$

3.2.2 Measurement of Performance

To measure the firms financial performance, researchers generally use accounting based measures such as Return on Assets (ROA), Returns on Sales (ROS) and Returns on Equity (ROE), or market based measures such as Tobins Q and market returns of stocks [205, 206, 207]. Both accounting and market based measures are considered as valid indicators for financial performance of the firms. In this study, this study takes two accounting based measure i.e. ROA and ROE and a market based measure i.e. stock market returns to measure the firms performance.

3.2.3 Measurement of Capital Structure Decision

The term capital structure is refer to the way a firm is financing its assets through the mixture of debt and equity [208]. The capital structure of the firm can be measured as the ratio between the total debt and total equity [209]. Basically the form of financing and the types of the sources for funds will define the capital structure of the firm. The process of the financing is very crucial for the management of the firm because it is important and it ensures the financial continuity is essential for the growth of the firm. This study measure capital structure of the firm through ratio of total debt to total equity.

3.2.4 Measurement of Working Capital Management decisions

The term working capital refer to the funds that firms utilize in their daily activities or the operations. Working capital is the available funds that are used to conduct

day to day operation of an organization which is represented by the current assets [210]. In the same manners, according to [211] the working capital are describe as items that are needed for the day to day production of good to be sold by the company. Hence, it is the excesses of current assets over current liabilities.

Working capital is the most important element of the balance sheet. The working capital can be calculated as current assets minus current liabilities. From this equation it is called net current assets. It is the cash that firm needs for their day to day operations, or more specifically, for financing the conversion of raw materials into finished goods, which come sell for payment. According to [212] decisions that are related to working capital and short term financing are referred to as working capital management. The working capital management is measured by dividing net working capital by total assets.

3.2.5 Measurement of Dividend Policy Decisions

For the measurement of dividends there are two very common measures are used that is dividend pay-out ratio and dividend yield. These two methods are reliable, but both measure dividends in different manners. The definition of dividend pay-out is as the percentage of the earnings of the company that is distributed to shareholders. The formula of dividend pay-out ratio is dividend per share divided by earnings per share which consider internal factors and measurement is independent of external factors [213]. As compare to dividend pay-out ratio, dividend yield is influenced by the external factors because it consider the stock prices of the shares [214]. This study uses dividend pay-out ratio as a measure of dividend policy.

3.2.6 Methodology for Separating Manager Specific Effects

To examine whether the individual managers influence strategic financial decisions (capital structure decision, dividend policy decisions and working capital management decisions), idiosyncratic risk and performance of the firm. the study employs

TABLE 3.1: Variables, definition and Sources

	Variables	Definition	Sources
1	Idiosyncratic risk	Weighted average of firm within in industry multiple with residuals of firm with industry	[90]
2	Performance	Return on Assets, Return on Equity, Stock market returns	[205, 206, 207]
3	Capital structure	Total debt to total equity	[208]
4	Dividends policy	Dividend per share to earnings per share	[213]
5	Working capital management	Net working capital to total assets	[212]

the movement of managers method proposed by [1] to study the fixed effects of the managers. The implementation of this method is described below:

3.2.6.1 The Manager Mobility Method

This study uses the methodology proposed by [1] to study the fixed effects of the managers. The method is known in the literature as the manager mobility method or the movement of managers⁵. [1] first used this methodology to study the role of managers in different corporate strategies. In order to trace the mobility of managers through various organizations, this methodology enables the researchers to distinguish between variations caused by the managers fixed effects and the firms fixed effects.

Suppose, in order to understand the idea behind this methodology, that the researcher is interested to see how the decisions of firm A are being influenced by manager X. The researcher will use the following method to study this question:

$$Y_{it} = \alpha + \beta Controls_{it} + M_X + \varepsilon_{it} \quad (3.24)$$

Where Y_{it} refers to the decisions of the firm i at the time t , the represents the vector of control variables that are known in the literature to affect the decisions of the firm i , and M_x is the dummy variable equals one for manager x (that is, a

⁵[61] define the manager mobility method as the mover dummy variable (MDV) method.

manager at firm i at time period t) and zero otherwise. However, one caveat with such a methodology exists while interpreting the coefficient on M_x . It is difficult to distinguish between the firm fixed effect and the fixed effects of manager X from above specification⁶. In order to isolate the manager fixed effect from firm fixed effect, the researcher need to include fixed effect of both manager and firm in the specification of the regression as follow:

$$Y_{it} = \alpha + \beta Controls_{it} + F_i + M_X + \varepsilon_{it} \quad (3.25)$$

In this equation F_i represents a dummy variable that equals one in case of firm i and zero if not. Through the use of this specification, one can distinguish between manager and firm fixed effects. For example, the firms fixed effects are being controlled by coefficients of F_i , therefore, the coefficients on M_x represent the influence of manager X on the decisions of firm i . However, there is an empirical issue with such specification if X is the single manager, in that case firm fixed effects and manager fixed effects are perfectly collinear.

One solution to the above problem is given by [1] by tracking the managers who move from one to another firm. In order for a manager to be part of the study, they make it necessary for the manager to at least once change the firm in his/her career. Additionally, for the manager to mark the style at the firm, he/she must also serve each firm for at least three years.

The example shown in figure 3.1 explains this points more precisely, in case of a manager who is part of this study. Gareth Bullok was Chief Operating of Tesco PLC from 2001 to 2008. When he left Tesco PLC he become Chief Executive Officer of Informa PLC from 2009 to 2014. In the dataset the following observations of year and firm are included for Tesco PLC and Informa PLC:

Now replace F_i in equation (b) with F_{Tesco} and $F_{Informa}$ and replace M_i with M_{Gareth} : $F_{Tesco} = 1$ for all available years of data for Tesco PLC from 2001-2014
 $F_{Informa} = 1$ for all available years of data for Informa PLC from 2001-2014
 $M_{Gareth} = 1$ from year 2001- 2014

⁶This is the assumption which is maintained by the neoclassical economic theory.

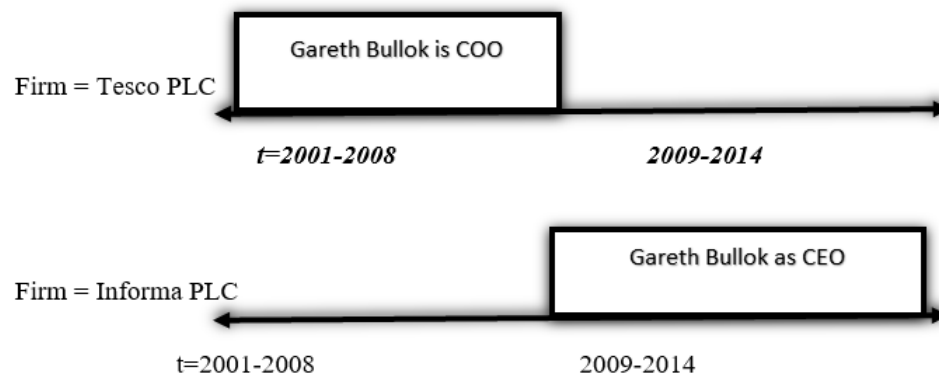


FIGURE 3.1: Manager Mobility Method

Here the fixed effect of Gareth Bullok is measured from 2009 to 2014 (over his tenure at Tesco PLC and Informa PLC) and is interpreted as the incremental fixed effect of Gareth Bullok on firm strategic financial decisions (capital structure decision, working capital decision and dividend policy decision), idiosyncratic risk and performance of the firm after controlling of Informa PLC and Tesco PLC (estimated using all firm and year data)⁷. The estimated coefficient is style of Gareth Bullok.

The key benefit of manager mobility method is that it allows the researcher to identify the separate incremental influence of the manager on the decision variable of interest while to control the time invariant and characteristics of firms.

3.2.7 Measurement of Other Variables (Control Variables)

Control variables in models (3.1) through (3.4) include firm and macro level characteristics that are expected to influence financial decisions. The internal factors that can affect capital structure decisions are size, profitability, tangibility and non-debt tax shield [11, 215, 216]. According to the Rajan and Zingales (1995) the impact of size on leverage is very vague. They find that the larger firms are tend to be more diversified and often fail less as compare to the small firms so size may be inverse proxy for the profitability of bankruptcy. The empirical studies do

⁷In this study we also control the determinants of all variables and also control the time fixed effect.

not provide any clear results. Some studies find that there is positive relationship between the size and leverage [217, 218, 219]. Whereas some studies report negative relation between size and leverage [208, 220, 221]. The relationship between profitability and leverage is not clear. According to the tradeoff theory the firms who earn more profits have higher leverage because they have more income to shield from taxes. Whereas the free cash flow theory suggest that the profitable firms should use more debt in order to discipline managers, and encourage them to pay cash instead of spending in inefficient projects. Whereas according to the view of pecking order theory the firm should use internal financing so profitable firm have a lower need for external finance and have lower leverage. Most of the studies show that there is negative relation between leverage and profitability [208, 217, 218, 220, 222, 223]. Tangible assets of the firms are used as collateral. When the tangibility is higher it means firms have lower credit risk and the value of assets increases in case of bankruptcy. According to [222] when the firm has more tangible assets, the greater its ability to issue secured debt and the less information revealed about the profit of future. So there is positive relationship between the leverage and tangibility [208, 217, 219]. Whereas [218?] find negative relationship. According to [224] all other things remain constant, decrease in allowable investment related to tax shield due to change in the corporate tax or due to change in inflation that decrease the real value tax shield will increase the amount of debt that firm employ. So, the firms that have lower investment related tax shield will use greater debt in their capital structure. There the relationship between the tangibility and leverage is negative [208, 218, 221, 224?]. Whereas [225] find positive relationship between tangibility and leverage.

The external factors relevant to capital structure include corporate tax, industry classification [102, 220, 226], cost of debt [227] and internal equity [228]. According to the tradeoff theory, company with high tax should use debt and therefore have higher leverage, because it has more income from tax shield. Some previous studies show that there is statistically significant relationship between classification of industry and leverage.

Whereas the factors influencing dividend policy decision include profitability, current ratio, corporate tax and debt to equity ratio [229]. Profitability is the most important determinant of dividend payout ratio. According to previous researches the results are mixed. According to the pecking order theory the firm will prefer to depend on internal funds that is also known as retained earnings. So the firm has tendency to pay less dividend and having more retained earnings. The firms who generate profits or are more profitable will prefer to pay less dividends. According to [229] the profitability of the firm is highly negative and significant related with the dividend payout, which show that the firms invest in their assets rather than paying dividend to their shareholders. Whereas, [230] find that when the return on equity of firm is higher, the retained earnings of the firm for reinvestment are greater and dividend payout is lower. As opposite to these views [231, 232] find that profitable firms tend to pay more dividends. They find there is positive relationship between dividend and profitability of the firm. The reason is that the profitable firms are more stable and they have more free cash flow so they can afford to pay their earnings as dividends. Whereas, when we talk about the liquidity as a determinant of dividend payout. [233] find that the firms who have more liquidity they pay more dividend as compare to the firms which have liquidity problem. The dividend payment is reply on the cash flows which reflect the companys ability to pay dividends. A poor liquidity position of the firm mean that firm has shortage of cash so they pay less dividends. Whereas [234] find that liquidity is irrelevant for the consideration of the dividend policy and find that liquidity is insignificant for decision of dividend policy. The other important determinant of dividend policy is leverage. According to [139, 235] when firms pay high interest payment they have less cash flow to pay as a dividend. So there is negative relationship between leverage and dividend payout. [236] find positive relationship between corporate tax and dividend payout. The firms whose trend of tax liability increasing their preference for dividend payment is also increasing. Whereas [229] also find the same results. They find that increasing tax leads to increasing dividends.

Working capital decision is the most important decision of the firm. According

to [237] working capital decisions are influenced by sales growth, size, portion of fixed assets and leverage. Some researchers find there is no statistical significant relationship between working capital and size of the firm [238] whereas [239, 240] find positive relationship between working capital and size of the firm. The profitability of the firm is another factor that affect the working capital. Different studies found positive relationship between profitability and working capital [238, 240, 241], whereas [242] find negative correlation between profitability and working capital. On the other hand the profitable firms with high sales growth face higher risk of becoming overwhelmed by liquidity problems and thus bankruptcy than firms not growing. So the growing firms need extra capital to invest in stocks and receivables through which a firm could run shortage of cash being unable to pay their bills [238]. [240] suggest that growing firms should pay more attention to working capital management. In prior literature these are identified as economic determinants of financial decisions. The other determinant of working capital management is leverage. [243] find there is significant relationship between leverage and inventory conversion period whereas there is significant positive relationship between leverage and conversion period. According to the [244] the determinants of idiosyncratic risk are price, size, leverage and return of asset. According to [245, 246] increase in level of leverage will intensify the volatility of shares return. Whereas [247] find there is a significantly positive relationship between idiosyncratic risk and expected returns.

Whereas for the firm performance there are certain firm characteristics that are linked with high performance of the firm. These include size [248], return on assets, leverage, liquidity [249] and sales [250]. According to [251] there is a considerable relationship between leverage and performance of the firms. [252] find the consistent results. The next determinant of profitability is firm size which is the most important determinant of performance of the firm. According to [253] there is negative relationship between the firm size and profitability of the firm. According to [254] the companies with growth have high profitability. If a company has high growth then it tend to be more profitable. [255] find negative relationship between liquidity and profitability.

In each corresponding model, the study controls for these variables to capture maximum variation in dependent variables.

3.2.8 Sample Description

Table 1 presents mean, median and standard deviation for the firm characteristics variables and financial decision variables (capital structure decisions, working capital decision, and dividend policy decision), idiosyncratic risk and performance of the firm. All variables are winsorized at 1% tail to mitigate the problem of outlier. The first six column report descriptive statistics of Pakistan and UK sharia compliant firms and next six columns report descriptive statistic of non-sharia compliant firms for Pakistan and UK. A descriptive account of variables is reported in Table 3-2. The average debt to equity for sharia compliant firms of Pakistan and UK is 1.53 and 1.54 respectively whereas for non-sharia compliant firm for Pakistan and UK is 1.7 and 2.2 respectively. As expected, the ratio of debt for sharia compliant firms is higher as compare to non-sharia compliant firms. The dividend pay-out ratio for SC firm for Pakistan and UK is 41.7% and 34% respectively. This may suggest that Pakistani firms are likely to pay more dividends as compared to UK firms. Return on assets for SC of Pakistan and UK is 11.08% and 10.25% respectively. Net working capital Pakistan and UK sharia compliant firms is 0.405 and 0.158. The ratio is high for Pakistan as compare to UK for both SC and NSC firms. The idiosyncratic risk for Pakistan is high as compare to the UK firm. The idiosyncratic risk for Pakistan SC firms is 2.2% whereas for UK it is 0.1%. Lower values on idiosyncratic risk for UK firms may also mean that the businesses in UK are more stable as compare to Pakistan. The differences in risk conditions may exist due to differences in economic condition of both countries. The average size of the UK firms is larger than Pakistan firms.

TABLE 3.2: Summary Statistics of Sharia and Non-Sharia Compliant Firm Characteristics

Manager-firm matched sample												
	Pakistan Sharia Firm			UK Sharia Firm			Pakistan Non-Sharia Firm			UK Non-Sharia Firm		
	Mean	Median	St. dev	Mean	Median	St. dev	Mean	Median	St. dev	Mean	Median	St. dev
Profitability	0.11	0.10	0.12	10.18	9.42	8.36	0.12	0.09	0.12	3.84	4.67	7.43
Size	4.55	4.41	1.51	13.52	13.77	1.95	3.69	3.85	1.66	13.60	13.68	2.45
Cost of debt	0.14	0.20	0.04	0.13	0.14	0.03	0.17	0.19	0.02	0.15	0.17	0.05
Volatility	0.08	0.10	0.05	0.06	0.08	0.01	0.15	0.17	0.07	0.12	0.13	0.03
Level of internal equity	0.56	0.58	0.13	0.64	0.62	0.10	0.58	0.55	0.12	0.68	0.68	0.06
Tangibility	0.67	0.73	0.21	0.47	0.48	0.26	0.65	0.70	0.21	0.48	0.48	0.26
Non Debt Tax Shield	0.03	0.03	0.02	-0.04	-0.04	0.03	0.03	0.03	0.02	-0.04	-0.04	0.03
Corporate Tax	0.21	0.24	0.19	-0.21	-0.25	0.18	0.23	0.25	0.20	-0.15	-0.20	0.21
Current Ratio	1.67	1.24	1.13	1.81	1.49	1.05	1.58	1.19	1.11	1.49	1.16	1.08
Debt to Equity	1.53	1.04	1.60	1.54	1.24	1.25	1.66	1.15	1.61	2.16	1.63	1.76
Dividend Pay-out	0.42	0.37	0.42	0.34	0.30	0.37	0.41	0.33	0.41	0.31	0.10	0.41
Sales growth	0.15	0.14	0.22	0.07	0.06	0.22	0.13	0.10	0.24	0.06	0.04	0.22
Portion of fixed Assets	0.45	0.43	0.26	0.54	0.57	0.20	0.40	0.39	0.22	0.59	0.63	0.23
Price	4.08	4.19	1.15	5.98	5.97	0.88	4.31	4.16	1.35	5.15	5.32	1.23
ROA	0.11	0.09	0.10	0.11	0.09	0.07	0.12	0.09	0.11	0.04	0.05	0.07
ROE	0.11	0.09	0.08	0.09	0.07	0.05	0.10	0.08	0.08	0.02	0.03	0.05
Idiosyncratic risk	0.02	0.01	0.03	0.00	0.00	0.00	0.01	0.00	0.01	0.00	0.00	0.00
Leverage	0.52	0.56	0.23	0.15	0.15	0.12	0.55	0.59	0.23	0.17	0.16	0.13
Working capital	0.41	0.36	0.22	0.16	0.15	0.12	0.45	0.44	0.23	0.10	0.06	0.12
sample size	375			1112			252			616		

Manager-firm matched sample includes: (1) firm-year observation for the sharia compliant firms that have at least one manager observed in multiple sharia compliant firms/non-sharia compliant firms with at least three year stay at each firm; (2) observations for these firms in the years in which they have other managers that we dont observe in multiple firms. b) We choose the sample of sharia compliant firm may be manager come from sharia compliant firm or non-sharia compliant firm. c) All variables are winsorized at 1% tail.

Chapter 4

Results and Discussion

The estimation results based on equation 1-4 and related discussion are provided in this section. The analysis has been divided in two sections. Section 4.1 is dedicated to the impact of managers fixed effects on financial decisions of sharia and non-sharia compliant firms. Section 4.2 reports and discusses the impact of managers fixed effects on firm performance and idiosyncratic risk.

4.1 Individual Manager Fixed Effect and Financial decisions

4.1.1 Significance of Incremental Explanatory Power of Manager Fixed Effects

Table 4.1 reports the results of F-test and adjusted R^2 from estimation of Equation (1) for the different financial decisions for Pakistan and UK firms. For every variable, this study reports in the first row the fit of a benchmark specification that includes only time varying firms controls, firm fixed effect and year fixed effect. In the next three line this study reports the change in adjusted R^2 after adding CEOs fixed effect, CFO fixed effect and fixed effect for all 3 groups of executives consecutively. The study also reports the result of F-statistics from the

joint significance of the different sets of managers fixed effect in second and third row. In last column the study report the F-stat for sharia compliant firms.

The results of Table 4.1 suggest that fixed effects of top executives matter both economically and statistically for the strategic financial decision in both samples (Pakistan and UK). Including CEOs and CFOs as well as other managers fixed effect significantly increase the adjusted R^2 of the estimated model. Similarly the study also find that the F-tests are large and it allows us to reject the null hypotheses that the managers fixed effect is jointly zero. The study also see that there are significant differences as to which decisions are most affected by the top executives. Moreover, the study comes to know that different managers matter for different decisions for example CFO matters for capital structure decisions. This is in accordance with [12].

4.1.2 Results for Pakistan

Panel A in table 4.1 reports the results of strategic financial decisions. The study starts discussion with first variable that is capital structure decision. The benchmark specification includes firms fixed effect, year fixed effect and control variables. The adjusted R^2 for the benchmark specification is 69 percent, it increases by 2 percent when CEO fixed effect are included. It further increases by 6 and 7 percent when the set of CFO fixed effect and other managers fixed effect respectively are included. Interestingly, the study can observe that fixed effects of CFOs as compare to CEOs and others are highly significant and their inclusion has an especially large impact on the adjusted R^2 . The next variable is dividend pay-out. For this variable, it is observe 2 percent increase in adjusted R^2 when CEO fixed effect are included. On the other hand when the fixed effect of CFOs and others are included the adjusted R^2 increases by 5 and 6 percent respectively. These findings shows that the CFOs and other managers matter more for dividend policy decisions as compare to CEOs. The last variable is working capital decision. For this variable, it is notice 1 percent increase in adjusted R^2 after inclusion of CEOs fixed effects whereas with the inclusion of fixed effect of CFOs and other the adjusted R^2 increases by 2 and 3 percent respectively.

4.1.3 Results for UK

Panel B in table 4.1, reports the results for managers fixed effects on strategic financial decisions for UK firms. The first variable is capital structure decision and benchmark specification includes firms fixed effect and year fixed effect. When CEO fixed effects are included the adjusted R^2 increases by 2 percent and when CFOs and other managers fixed effects are included, the adjusted R^2 increases by 3 and 4 percent respectively. The second variable of interest is dividend pay-out. It is observe that adjusted R^2 increases by 2 percent when CEOs fixed effects are included and by 3 and 4 percent when CFOs and other managers respectively are included. The last variable is working capital decision. For this variable we observe 2 percent increase in adjusted R^2 when CEO fixed effects are included, the adjusted R^2 increases by 2 and 3 percent when CFOs and other managers fixed effects are added.

In other regressions, not reported here, the study breaks down the categories into more specific job title like CFO, COO and CIO and find that CFOs explain most of the increase in adjusted R^2 as compare to others. According to [12] CEO doesnt run a firm by himself, there are so many people involved. For example CFO are naturally responsible for the corporate decision. Although, all top executives are important ingredient for the firm but empirically, we find that CFOs matter more than CEOs and for financial decisions.

4.1.4 Robustness Test: Persistence Effect or a One time Random Event

One of the most important concerns is that managers fixed effects identified above are not just because of the random event that occurred in one of the firms during the tenure of manager. For instance, a manager who happens be a part of the firm when firm is involved in lower external borrowing and paying high dividend; the study may estimate a positive manager fixed effect for that manager even though that effect does not persist in his/her future firm. To address this concern, it is examine whether this positive effect of manager is driven by just one of the firm or

it may persist across the different firm where he/she work during their career. For this purpose, the study estimates firm-year residuals by regressing strategic financial decision variables on firms fixed effect, year fixed effect and control variables, so the managers fixed effects are left in the residuals. For the managers significant effect on strategic financial decisions, the study find significant correlation between the residual of first firm and residual of second firm¹. In un-tabulated result, the study find significant and positive association between the residuals of managers first firm and second firm . The results indicate that managers fixed effect on strategic financial decision are their individual effect which stagnate from firm to firm and their effect are persistence and not driven by a random event at only one firm.

Second, it is argue that there is no active influence of manager on his/her first firms policies but by coincidence he/she may be involved in changes in the firms policies. Other firm mistakenly assume that the change occur due to managers active influence and that firm also want same change and will hire this specific manager. In this scenario, we would examine a significant manager effect which is not due to the managers active influence. To provide evidence that manager fixed effect are due to managers active influence, we analyse the timing of the change in firms financial decisions. In the above outlined story, one would expect that some of the change in financial decisions precede the arrival of the new manager, so the board has already decide to undertake changes this is not because of the managers fixed effect. If the changes in financial decisions will only occur due to the active influence of manager then this change only will occur when manager is hired. The study repeat the process of last paragraph but now it is assume that each manager arrives in his second firm three years prior the date he/she actually joins the firm. Un-tabulated results show that correlation between first firm and second firm is highly insignificant² . The result show that the change in firm strategic financial decision occur after and not before to the arrival of new

¹The correlation is 0.269(p=0.012) for capital structure, 0.317 (p=0.003) for dividend pay-out and 0.244(p=0.023) for working capital decision for Pakistan firms whereas for UK the correlation is 0.228(p=0.001) for capital structure, 0.384 (p=0.000) for dividend pay-out and 0.323(p=0.003) for working capital decision.

²The correlation is 0.117(p=0.272) for capital structure, - 0.001 (p=0.989) for dividend pay-out policy and -0.185(p=0.081) for working capital decision for Pakistan firms whereas for UK

manager and it also confirm that manager has an active influence on strategic decision of the firm.

4.2 Individual Manager Fixed Effect and Firms Performance and Idiosyncratic Risk

4.2.1 Significance of Incremental Explanatory Power of Manager Fixed Effects

Table 4.2 reports the results of F-test and adjusted R^2 from estimation of equation (1) for the different firms performance and idiosyncratic risk for Pakistan and UK firms. For every variable, the study report in the first row the fit of a benchmark specification that includes only time varying firms controls, firm fixed effect and year fixed effect. In the next three line the study reports the change in adjusted R^2 after adding CEOs fixed effect, CFO fixed effect and fixed effect for all 3 groups of executives consecutively. The study also reports the result of F-statistics from the joint significance of the different sets of managers fixed effect in second and third row. The results of Table 4.2 suggest that fixed effects of top executives matter both economically and statistically for the firms performance and idiosyncratic risk in both samples (Pakistan and UK). Including CEOs and CFOs as well as other managers fixed effect significantly increase the adjusted R^2 of the estimated model. Similarly the study also finds that the F-tests are large and it allows us to reject the null hypotheses that the managers fixed effect is jointly zero. It is also see that there are significant differences as to which firms performance and idiosyncratic risk are most affected by the top executives. Moreover, the study comes to know that different managers matter for different decisions for example CFO matters for capital structure decisions.

the correlation is 0.017(p=0.865) for capital structure, 0.135 (p=0.183) for dividend pay-out policy and -0.044(p=0.662) for working capital decision.

TABLE 4.1: Manager Fixed Effects on Financial Decisions

Panel A: Pakistan					
<i>F-test on fixed effect for</i>					
	CEO	CFO	Others	N	Adjusted R^2
Leverage				627	0.69
	56.52 (<0.0001)			627	0.71
	76.01(<0.0001)			627	0.75
	340(<0.0001)	42.09(<0.0001)	4.93(0.0008)	627	0.76
Dividend Payout				627	0.33
	14.83(<0.0001)			627	0.35
	13.42(<0.0001)			627	0.39
	181.92(<0.0001)	15.37(<0.0001)	2.99(0.02)	627	0.39
Working Capital				627	0.85
	222.25(<0.0001)			627	0.86
	228.05(<0.0001)			627	0.87
	5490(<0.0001)	54.80(<0.0001)	46.13(<0.0001)	627	0.88
Panel B:UK					
<i>F-test on fixed effect for</i>					
	CEO	CFO	Others	N	Adjusted R^2
Leverage				1728	0.75
	173.30(<0.0001)			1728	0.77
	178.90(<0.0001)			1728	0.78
	3554(<0.0001)	8544(<0.0001)	501.61(0.0001)	1728	0.79
Dividend Pay out				1728	0.28
	11.15(<0.0001)			1728	0.3
	16.12(<0.0001)			1728	0.32
	916.81(<0.00001)	366(<0.0001)		1728	0.33
Working Capital				1728	0.85
	455.08(<0.0001)			1728	0.87
	705.34(<0.0001)			1728	0.87
	4551.18(<0.0001)	275(<0.0001)	91.13(<0.0001)	1728	0.88

a) Sample is the manager-firm matched panel data. b) Results that are reported in table are the fixed effect panel regression, where standard error are clustered at firm level. For each dependent variable (as reported in column 1), the fixed effects included are row 1: firms fixed effects, year fixed effects; row 2: firm, year and CEO fixed effects; row 3: firm, year, CEO and CFO fixed effect and row 4: firm, year and all managers fixed effects. c) Reported in Panel A and B are the F-test joint significance of CEO fixed effects (column 2), CFO fixed effects (Column 3) and all managers fixed effect (column 4) of Pakistan and UK firms. For each F- test we report the value of F-Statistic and p-value.

4.2.2 Results for Pakistan

Panel A in table 4.2 reports the results of idiosyncratic risk and performance of the firms. The study starts discussion with idiosyncratic risk. The benchmark specification includes firms fixed effect, year fixed effect and control variables. The adjusted R^2 for the benchmark specification is 5.7 percent, it increases by 8 percent when CEO fixed effect are included. It further increases by 13.63 and 13.69 percent when the set of CFO fixed effect and other managers fixed effect respectively are included. Interestingly, it can observe that fixed effects of CFOs and others as compare to CEOs are highly significant and their inclusion has an especially large impact on the adjusted R^2 . According to [256] CFOs exposed more company risk as compare to CEOs. For ROA and ROE (accounting based measure for performance), it is observe that 2.76 and 3 percent increase in adjusted R^2 respectively when CEO fixed effect are included. On other hand when the fixed effect of CFOs are included the adjusted R^2 increases by 11.97 and 5.31 percent respectively for ROA and ROE. These findings shows that the CFOs and other managers matter more for company performance as compare to CEOs. For stock price (Market based measure of performance), it is notice that 8.45 percent increase in adjusted R^2 after inclusion of CEOs fixed effects whereas with the inclusion of fixed effect of CFOs and other the adjusted R^2 increases by 15.87 percent. According [257] CFOs of the firms retain the crucial responsibility for the design and implementation of the policy decisions that are directly linked with performance of the firm. In summary, CEOs/CFOs are matter for the firm and this is prove through the results.

4.2.3 Results for UK

Panel B in table 4.2, reports the results for managers fixed effects on idiosyncratic risk and performance of UK firms. The first variable is idiosyncratic risk and benchmark specification includes firms fixed effect and year fixed effect. When CEO fixed effects are included the adjusted R^2 increases by 3.38 percent and when CFOs and other managers fixed effects are included, the adjusted R^2 increases by

9.11 and 10.86 percent respectively. In case of ROA and ROE, it is observe that adjusted R^2 increases by 4 and 3.04 percent respectively when CEOs fixed effects are included and by 10.77 and 6.58 percent for ROA and ROE respectively when CFOs are included.

For stock prices, the study observes 3.36 percent increase in adjusted R^2 when CEO fixed effects are included, the adjusted R^2 increases by 13.28 and 19.35 percent when CFOs and other managers fixed effects are added.

In other regressions, not reported here, the study breaks down the categories into more specific job title like CFO, COO and CIO and find that CFOs explain most of the increase in adjusted R^2 as compare to others. According to [12] CEO doesnt run a firm by himself, there are so many people involved. For example CFO are naturally responsible for the firms performance and idiosyncratic risk. Although, all top executives are important ingredient for the firm but empirically, the study finds that CFOs matter more than CEOs and for firms performance and idiosyncratic risk.

4.3 Movement of Executives across Firms

The finding of the study above indicates that managers idiosyncratic styles are the most important ingredient of financial decisions, idiosyncratic risk and performance of an organization but some evidence consistent with the absence of styles effect. The ordinary question arise how board identity an individual managers financial style when selecting an executive. The work of Bertrand and Schoar (2003) is very important they suggest that styles of managers can be identify by examining the choices of individuals policy at the previous firm. If the style is fixed or innate characteristics then individual should display a similar styles across different firm³.

³A very famous example of Al Dunlap, a CEO who displayed a style of massive cost cutting across different firms. The question arise is whether the styles portability reflects a more general phenomenon [258]. According to [177] portability of managers styles depend on personal and corporate borrowing choices.

TABLE 4.2: Manager Fixed Effects on Financial Decisions

Panel A: Pakistan					
<i>F-test on fixed effect for</i>					
	CEO	CFO	Others	N	Adjusted R^2
Idiosyncratic Risk				627	0.057
	4.61(<0.0001)			627	0.137
	3.62(<0.0001)			627	0.1933
	3.66(<0.0001)	3.32(<0.0001)	2.13(<0.0001)	627	0.1939
ROA				627	0.2801
	2.45(<0.0001)			627	0.3077
	3.39(<0.0001)			627	0.3998
	5.26(<0.0001)	6.10(<0.0001)	7.79(<0.0001)	627	0.4391
ROE				627	0.2947
	3.78(<0.0001)			627	0.3247
	6.18(<0.0001)			627	0.3478
	5.89(<0.0001)	4.85(<0.0001)	8.75(<0.0001)	627	0.3886
Stock Price				627	0.3637
	6.59(<0.0001)			627	0.4482
	6.15(<0.0001)			627	0.5224
	8.01(<0.0001)	6.22(<0.0001)	10.58(<0.0001)	627	0.5224
Panel B: UK					
<i>F-test on fixed effect for</i>					
	CEO	CFO	Othes	N	Adjusted R^2
Idiosyncratic Risk				1728	0.1383
	3.20(<0.0001)			1728	0.1721
	3.57(<0.0001)			1728	0.2294
	3.18(<0.0001)	3.73(<0.0001)	2.06(<0.0001)	1728	0.2469
ROA				1728	0.0135
	3.29(<0.0001)			1728	0.0535
	3.94(<0.0001)			1728	0.1212
	3.89(<0.0001)	3.38(<0.0001)	3.77(<0.0001)	1728	0.1715
ROE				1728	0.1278
	2.54(<0.0001)			1728	0.1582
	2.69(<0.0001)			1728	0.1936
	3.15(<0.0001)	4.52(<0.0001)	2.81(<0.0001)	1728	0.1989
Stock Price				1728	0.0432
	2.95(<0.0001)			1728	0.0768
	5.02(<0.0001)			1728	0.1760
	4.82(<0.0001)	5.42(<0.0001)	4.63(<0.0001)	1728	0.2367

a) Sample is the manager-firm matched panel data. b) Results that are reported in table are the fixed effect panel regression, where standard error are clustered at firm level. For each dependent variable (as reported in column 1), the fixed effects included are row 1: firms fixed effects, year fixed effects; row 2: firm, year and CEO fixed effects; row 3: firm, year, CEO and CFO fixed effect and row 4: firm, year and all managers fixed effects. c) Reported in Panel A and B are the F-test joint significance of CEO fixed effects (column 2), CFO fixed effects (Column 3) and all managers fixed effect (column 4) of Pakistan and UK firms. For each F- test the study reports the value of F-Statistic and p-value.

To study this possibility in the sample, the study identifies all CEOs and CFOs who were previously employed as CEOs /CFOs at other sample firm during the sample period. This study eliminates the cases in which old employer was acquired by the new employer. Akin to [1] the same imprinting condition that manager servers in a top executive position at each firm for at least three years.

The study follows the same methodology of the Bertrand and Schoar (2003), the study estimates the regressions for each of the three dependent variables. The study includes all variables firm-years fixed effect in the regressions and also include firm specific control variables. Then it obtains average regression residuals of new and old employer than the study estimates the correlation between new employer and old employer. Though [1] report evidence of very strong relation, but the study does not uncover any parallel evidence. Un-tabulated results show that the relationship between first firm and second firm is highly insignificant ⁴. The results of the study are consistent with [13].

4.4 Direction of coefficient of CEOs/CFOs

It is difficult to interpret the direction of coefficients on CEOs/CFOs at this point. So far the study has identified managerial fixed effects are important in explaining the cross sectional variation in dependent variables. However, if observable characteristics of managers which lead to financial styles/managers fixed effect can be outlined. It is possible that some of these characteristics may have the effect on the dependent variables while other have negative impact. The coefficient on CEOs/CFOs are likely to get the sign dominant characteristics. The study has conducted an analysis taking two observable characteristics in section 4.8. The table 4-8 has reported the direction of coefficients of CEOs/CFOs.

⁴The correlation is 0.070(p=0.452) for idiosyncratic risk, 0.152 (p=0.098) for ROA and -0.039(p=0.676) for ROE 0..785(p=0.4785) for stock price of Pakistan firms whereas for UK the correlation is- 0.074(p=0.468) for idiosyncratic risk, -0.089 (p=0.380) for ROA, -0.0785 (p=0.425) for ROE and -0.163(p=0.106) for stock price.

TABLE 4.3: **Direction of Coefficient of CEOs/CFOs**

Dependent variables	Pakistan				UK			
	CEOs		CFOs		CEOs		CFOs	
	Pos	Neg	Pos	Neg	Pos	Neg	Pos	Neg
Leverage	8	4	9	8	15	17	18	22
Working capital	5	7	11	6	20	12	25	15
Dividend payout	6	6	7	10	18	14	31	9
Idiosyncratic Risk	10	2	12	5	24	8	21	19
Return on Assets	8	4	8	9	19	13	28	12
Returns on Equity	4	8	13	5	14	18	13	27
Share Price	9	3	10	7	25	7	26	14

Pos=Positive Neg=Negative

4.5 Magnitude of Manager Fixed Effects

Previous results show that manager fixed effect explain a significant fraction of variation in firm strategic financial decisions, now the study would like to gain more insight into the economic magnitude of the manager effects on strategic financial decisions and difference between managers. The study reports the size distribution of Pakistan and UKs managers fixed effect in panel A and panel B respectively of Table 4. The study shows mean, standard deviation, 25th percentile, median and 75th percentile.

Overall, Table 4.3 panel A and Panel B show that the variation in the size of manager fixed effects is economically large. For the distribution of manager fixed effects on strategic financial decisions, the difference between a manager at 25th percentile and 75th percentile is 1.19 for Pakistan and for UK the difference is -0.37 compare with average level of 0.52 for Pakistan and 0.16 for UK. In Pakistan the managers who are in bottom quartile decrease the leverage by 11 percent and the manager who are in upper quartile increase the leverage level by 8 percent. The UK managers who are in lower quartile decrease the leverage by 16 percent and the managers who are in upper quartile increase the leverage level by 8 percent. Whereas the distribution of manager fixed effects on idiosyncratic risk, the difference between a manager at 25th percentile and 75th percentile is 0.0026 for Pakistan and for UK the difference is 0.0007 compare with average level of 0.0154 for Pakistan and 0.00074 for UK. In Pakistan the managers who are in bottom

TABLE 4.4: Size Distribution of Manager Fixed Effects

Panel A: Pakistan					
	Mean	St.Dev	p25	p75	p50
Leverage	0.007	0.137	-0.112	0.087	0.025
Dividend Payout	-0.021	0.289	-0.177	0.194	0.046
Working Capital	0.006	0.137	-0.111	0.087	0.025
Idiosyncratic Risk	0.015	0.019	0.003	0.024	0.006
ROA	0.113	0.103	0.3	0.182	0.095
ROE	0.109	0.088	0.0247	0.168	0.084
Stock Price	0.041	0.012	0.032	0.151	0.042
Panel B: UK					
	Mean	St.Dev	p25	p75	p50
Leverage	-0.020	0.261	-0.162	0.112	-0.031
Dividend Payout	-0.005	0.061	-0.035	0.028	-0.003
Working Capital	0.007	0.041	-0.021	0.018	-0.0003
Idiosyncratic Risk	0.001	0.001	0.000	0.001	0.000
ROA	0.08	0.069	0.029	0.134	0.074
ROE	0.068	0.048	0.019	0.118	0.065
Stock Price	0.057	0.01	0.05	0.06	0.057

a) The fixed effect used in this table are retrieved from Table the regression in Table 2 row (4) b) Column 1 reports mean fixed effect for each financial decision variable, column 2 reports the standard deviation of the fixed effect, column 3, 4 and 5 report fixed effect at 25th percentile, 75th percentile and 50th percentile of the distribution, respectively.

quartile increase the firm performance by 3 percent and the manager who are in upper quartile increase the firm performance by 18.3 percent. The UK managers who are in lower quartile increase the performance by 2.88 percent and the managers who are in upper quartile increase the performance by 13.42 percent.

According to [1] the variation in the size of the manager fixed effect is economically large. They also claim that the difference between upper quartile and the average values for leverage, capital expenditure and corporate performance are attributable to managers fixed effect.

4.6 Movement of CEOs and CFOs from Sharia Compliant and non-sharia Compliant Firms

In all the analyses above, the study uses at least two companies for each CEO and CFO in which they moved. The study also selects the CEOs/CFOs of Sharia compliant firms who may have moved in from either sharia compliant firm or non-sharia compliant firms. In un-tabulated results the coefficient of sharia compliant firm is significant which meant the decisions of sharia compliant firms are different from non-sharia compliant firms. For sharia compliant firms, there are certain Islamic rules and guidelines which they must follow. According to sharia rules, sharia compliant firms are not allowed to involve in production of any prohibited product and debt are discouraged. When CEOs/CFOs move from non-sharia compliant firm to sharia compliant firm they need to follow the rules of that firm. [13] criticize whether manager imprints their own preferences on the corporation, or are they selected to implement the preference of the board? The objective of the study is to identify whether the managers who come from sharia compliant firm have distinctive financial styles as compare to those who move from non-sharia compliant firm.

To check this possibility in the sample, the study regress decision variables on firm fixed effect year fixed effect, control variable, CFO fixed effect and others fixed effect in equation (1) to capture the fixed effect of CEO. The study then calculate the residuals for Sharia and non-sharia compliant firms, these residual represent the fixed effect of CEOs. The same process are repeat for CFOs and get residuals which represent CFOs fixed effects. To test the difference in sharia styles of manager who moved from sharia or non-sharia compliant firms, the study applied t-test on both groups (movement of CEOs/CFOs from non-sharia to sharia compliant firms or from sharia to sharia compliant firm). These results are reported in table 4.4 and table 4.5.

Panel A and B compares fixed effect of CEOs and CFOs who move from non-sharia to sharia compliant firms and from sharia to sharia compliant firms of UK and Pakistan. When the study compare the movement from non-sharia to sharia

complaint firms all t-statistics are significant, suggesting that there is significant difference between CEOs and CFOs who worked in non-sharia complaint firm and now join sharia complaint firm in term of their individuals effects in financial decisions. Whereas when the study compares CEOs and CFOs who move from sharia to sharia complaint firm, all t-statistic are insignificant which indicate that there is no significant difference between CEOs and CFOs who move from sharia to sharia compliant firm in term of their individual effects on financial decisions, idiosyncratic risk and performance of the firm.

TABLE 4.5: Movement of CEOs and CFOs from Sharia to Sharia Compliant firm or Non-sharia to Sharia Compliant firm of UK

Panel A: UK: CFO Movement										
	Non Sharia	Sharia	Differential Mean	t-stat	p-value	Sharia	Sharia	Mean	t-stat	p-value
Leverage	-0.03	0.03	-0.06	-3.42	0.001	0.004	0.008	-0.004	-0.36	0.72
DPO	-0.015	0.031	-0.05	-2.38	0.02	0.013	0.06	0.08	1.85	0.07
Working Capital	-0.02	0.007	-0.026	-2.28	0.03	0.01	0.004	0.007	0.622	0.537
Idiosyncratic Risk	0.0007	0.001	-0.0003	6.90	0.0002	0.0006	0.0008	-0.0002	-1.408	0.08
ROA	12.09	9.72	2.38	-2.83	0.02	6.96	7.31	-0.35	-0.508	0.305
ROE	10.79	7.24	3.55	-2.87	0.03	5.79	6.79	-0.99	0.79	0.46
Share Price	7.13	8.01	-0.87	-1.84	0.034	5.56	5.76	-0.203	-1.52	0.064
Panel B: UK: CEO Movement										
	Non Sharia	Sharia	Differential Mean	t-stat	p-value	Sharia	Sharia	Mean	t-stat	p-value
Leverage	0.002	-0.02	0.02	2.12	0.038	0.02	0.003	0.017	1.13	0.27
DPO	-0.007	-0.12	0.11	2.29	0.03	0.12	0.04	0.08	1.02	0.315
Working Capital	-0.0021	0.0137	-0.0158	-2.24	0.028	0.0052	0.0042	0.0009	0.07	0.09
Idiosyncratic Risk	0.001	0.001	0.0003	-2.70	0.046	0.0003	0.001	-0.001	1.51	0.07
ROA	4.71	9.12	-4.41	-5.92	0.0002	12.75	10.59	2.15	1.23	0.11
ROE	3.17895	6.12589	-2.94694	-3.8967	0.00245	10.8965	8.6987	2.1978	1.49	0.14
Share Price	5.51	5.64	-0.13	-2.76	0.015	7.24	8.24	-0.99	-1.32	0.095

a) Panel A and B summarize CFO and CEO of UK firms who move from non-sharia compliant to sharia complaint firms and Sharia to Sharia compliant firms. b) Reported in Panel A and B is the comparison of fixed effects of managers who moved from non-sharia to sharia compliant firms and sharia to sharia compliant firms for UK. c) t-statistic significant at the 5% level.

TABLE 4.6: Movement of CEOs and CFOs from Sharia to Sharia Compliant firm or Non-sharia to Sharia Compliant firm of Pakistan

Panel A: Pakistan: CFO Movement										
	Non Sharia	Sharia	Differential Mean	t-stat	p-value	Sharia	Sharia	Mean	t-stat	p-value
Leverage	0.036	0.009	-0.05	-2.19	0.03	0.02	0.002	0.018	0.60	0.56
DPO	-0.005	0.13	-0.14	-2.27	0.03	-0.078	-0.053	-0.025	-0.27	0.79
Working Capital	-0.041	0.003	-0.045	-2.34	0.026	-0.014	0.006	-0.02	-1.14	0.27
Idiosyncratic Risk	0.006	0.016	-0.01	-2.51	0.007	0.024	0.017	0.008	0.173	0.237
ROA	12.34	8.19	4.15	2.74	0.004	15.08	16.54	-1.46	-0.694	0.24
ROE	10.9	8.12	2.77	2.70	0.008	13.48	12.79	0.69	0.8759	0.16
Share Price	4.84	9.73	-4.93	3.903	0.0001	4.24	4.50	-0.26	0.491	0.126
Panel B: Pakistan: CEO Movement										
	Non Sharia	Sharia	Differential Mean	t-stat	p-value	Sharia	Sharia	Mean	t-stat	p-value
Leverage	-0.151	0.007	-0.16	-2.95	0.01	-0.007	-0.001	-0.006	-0.38	0.71
DPO	0.05	-0.14	0.192	2.17	0.04	-0.023	0.06	-0.08	-1.021	0.32
Working Capital	0.027	-0.045	0.072	2.59	0.019	0.012	0.052	-0.04	-1.24	0.32
Idiosyncratic Risk	0.013	0.005	0.121	3.99	0.0001	0.028	0.016	0.012	1.26	0.111
ROA	9.80	13.36	-3.56	2.21	0.017	20.11	13.73	6.38	-1.10	0.144
ROE	7.43	12.48	-5.05	2.79	0.025	24.79	16.49	8.30	-0.90	0.2698
Share Price	4.406	4.31	0.09	2.36	0.011	4.82	4.35	0.47	0.276	0.393

a) Panel A and B summarize CFO and CEO of Pakistani firms who move from non-sharia compliant to sharia complaint firms and Sharia to Sharia compliant firms. b) Reported in Panel E to H is the comparison of fixed effects of managers who moved from non-sharia to sharia compliant firms and sharia to sharia compliant firms for Pakistan. c) t-statistic significant at the 5% level.

4.7 Robustness Check: Movement of CEO and CFO across the Firms

In table 6 and table 7 the study reports the regression results for CEOs and CFOs of UK and Pakistani firms who moved either from non-sharia or sharia compliant firms. In previous section the study discusses the results from t-test for movement of CEOs and CFOs. To check the robustness of the results, the study regress the residuals of new firms (sharia complaint firms) of CEOs and CFOs on residuals of old firm (which may be sharia or non-sharia compliant firm) for all decision variables, idiosyncratic risk and performance of the firm.

The results show that the decisions of CEOs/CFOs who moved from sharia to sharia complaint firms are same in both firms, this is because of the nature of the firms i.e. the sharia complaint firms should obey the Islamic rules. Here if the study proceed with the critic of [13] which is the big challenge for research. According to them: do manager imprint their own preferences on the corporation, or are manager selected to implement the preference of the board? In this case managers are selected to implement the preferences of the board. The preferences of the board are to follow the Islamic rules. But its not the managers responsibility to guide a firm towards sharia compliance criteria through his/her decision. Rather, the manager can influence the firms financial decisions within the limits set forth by sharia compliance. Compliance to sharia rules is not incidental nor it is a choice for managers, but it is the basic principle upon which firms are supposed to carry out their business.

The results for CEOs/CFOs who move from non-sharia to sharia compliant firms are statistically insignificant. If the study looks at the magnitude of the coefficients it is low for those who move from non-sharia to sharia compliant firms as compare to those who move from sharia to sharia complaint firms. This is because the decisions in sharia compliant firms and non-sharia compliant firms are totally different.

TABLE 4.7: Robustness Check: Pakistani CFO and CEO Movement

Pakistani CFO Movement from:			
		Coefficient	p-value
	Sharia to Sharia	0.451	0.045
Leverage	Non-sharia to Sharia	0.251	0.204
	Sharia to Sharia	0.812	0.004
Dividend policy	Non-sharia to Sharia	-0.193	0.53
	Sharia to Sharia	0.466	0.05
Working capital	Non-sharia to Sharia	0.298	0.335
	Sharia to Sharia	0.56	0.034
Idiosyncratic Risk	Non-sharia to Sharia	0.163	0.257
	Sharia to Sharia	0.546	0.008
ROA	Non-sharia to Sharia	0.479	0.293
	Sharia to Sharia	0.457	0.012
ROE	Non-sharia to Sharia	0.589	0.354
	Sharia to Sharia	0.305	0.0114
Share Price	Non-sharia to Sharia	-0.0437	0.828
Pakistani CFO Movement from:			
		Coefficient	p-value
Leverage	Sharia to Sharia	0.995	0.049
	Non-sharia to Sharia	0.0038	0.882
Dividend policy	Sharia to Sharia	0.577	0.05
	Non-sharia to Sharia	-0.224	0.357
Working capital	Sharia to Sharia	0.376	0.047
	Non-sharia to Sharia	-0.135	0.75
Idiosyncratic Risk	Sharia to Sharia	-0.191	0.019
	Non-sharia to Sharia	-0.501	0.401
ROA	Sharia to Sharia	0.605	0.015
	Non-sharia to Sharia	-1.629	0.2
ROE	Sharia to Sharia	0.759	0.024
	Non-sharia to Sharia	1.875	0.426
Share Price	Sharia to Sharia	0.391	0.019
	Non-sharia to Sharia	-0.699	0.38

a)Column 1 and 2 reports the coefficient and p-value of CEO and CFO who moved from sharia to sharia compliant firm and non-sharia to sharia compliant firm. b)P-value significant at the 5

TABLE 4.8: **Robustness Check: UK CFO and CEO Movement**

UK CFO Movement from:			
		Coefficient	p-value
	Sharia to Sharia	0.132	0.017
Leverage	Non-sharia to Sharia	0.044	0.615
	Sharia to Sharia	0.335	0.006
Dividend policy	Non-sharia to Sharia	-0.091	0.38
	Sharia to Sharia	0.799	0
Working capital	Non-sharia to Sharia	-0.119	0.544
	Sharia to Sharia	-0.8202	0.008
Idiosyncratic Risk	Non-sharia to Sharia	-0.224	0.074
	Sharia to Sharia	-0.2484	0.05
ROA	Non-sharia to Sharia	0.1152	0.3959
	Sharia to Sharia	0.879	0.047
ROE	Non-sharia to Sharia	0.7854	0.4796
	Sharia to Sharia	-0.299	0.0077
Share Price	Non-sharia to Sharia	-0.134	0.2418
UK CEO Movement from			
		Coefficient	p-value
Leverage	Sharia to Sharia	0.135	0.048
	Non-sharia to Sharia	0.077	0.413
Dividend policy	Sharia to Sharia	-0.287	0.001
	Non-sharia to Sharia	-0.137	0.267
Working capital	Sharia to Sharia	0.894	0
	Non-sharia to Sharia	0.147	0.126
	Sharia to Sharia	0.204	0.009
Idiosyncratic Risk	Non-sharia to Sharia	-0.222	0.06
	Sharia to Sharia	0.487	1.46E-06
ROA	Non-sharia to Sharia	0.0712	0.514
	Sharia to Sharia	0.256	0.005
ROE	Non-sharia to Sharia	0.126	0.345
	Sharia to Sharia	1.008	2.40E-25
Share Price	Non-sharia to Sharia	0.097	0.3769

a) Column 1 and 2 reports the coefficient and p-value of CEO and CFO who moved from sharia to sharia compliant firm and non-sharia to sharia compliant firm. b) P-value significant at the 5

4.8 Observable Managerial Characteristics

Indications of systematic differences have been reconnoitred (in past studies) in strategic decisions of firm; amongst the top managers. Accordingly, presence of managers fixed effect wont describe as to which characteristics (in specific) may have affected their decision making. Here, the focus of the discussion revolves around two characteristics of managers; having an MBA degree and their age. It is expected that the manager who is MBA qualified their impact on managerial decisions area through social and human accumulation of because of their effect of selection. On the other hand, age might also be the one of the most relevant component because it is suggested that the aged managers are relatively more conservative while making decisions. To study the impact of managerial characteristics on financial decisions, idiosyncratic risk and performance, in this section, the study restricts the sample to CEO⁵. The study uses who was who and who is who data base to extract the data.

To estimate the impact of managerial observable characteristics on the strategic financial decisions of the firm, the study estimates the following Equation from [1].

$$Y_{jit} = \beta X_{it} + \delta MBA_j + \eta Cohort_j + \alpha_i + \lambda_t + \varepsilon_{jit} \quad (4.1)$$

Where i is for firms indexes, j is for CEO, t is for time, X_{it} is control variables, MBA_j is a dummy variables that is equal to 1 if CEO is qualified as MBA and otherwise 0, $Cohort_j$ is the age of CEO, α_i is firm fixed effect, λ_t is year fixed effect whereas ε_{jit} is a random term. In the Equation (4.1) $Tenure_j$ are included which captures the number of years that a CEO has been in office. The importance of this control is that it also accounts for the possible entrenchment or effects of career concerns. This study also allows the cluster of error term at the level of individual manager. There are two points which are important to discuss here about Equation (4.1). First this equation tries to identify within firm variation

⁵The study conducted similar analysis for CFOs and other managers and get similar results.

TABLE 4.9: **CEOs Age and MBA Effects on Firms Policies**

Panel A: UK CEOs		
	Age	MBA
Leverage	-0.210	-0.056
	0.000	0.000
Dividend payout	-0.462	0.065
	-0.010	-0.050
Working Capital	-0.006	0.014
	-0.890	-0.040
Idiosyncratic Risk	-0.002	-0.0003)
	0.000	0.000
Performance	-0.066	0.019
	-0.003	-0.010
Panel B: Pakistani CEOs		
Leverage	-0.080	0.143
	-0.030	-0.020
Dividend payout	0.673	-0.011
	-0.007	-0.040
Working Capital	-0.114	-0.003
	-0.020	-0.010
Idiosyncratic Risk	-0.005	0.000
	-0.001	0.000
Performance	-0.015	0.247
	0.000	0.000

a. Sample is based upon the firm-year data set for which we can easily get the information of age and Education of the CEO. b. Each row correspond to the different regression. The results of coefficients on age and MBA dummy are reported. The Equation is included the firm fixed effect, year fixed effect, control variable and tenure of CEO. c. Standard error are clustered at individual manager level.

in the MBA qualified or birth cohort of the CEO. Secondly, this study does not require to track the manager across different firms.

Table 4-9 reports the results of age and education of CEOs. Panel A reports the result for UK CEOs whereas Panel B reports the results for Pakistani CEOs. Reported in all rows of Panel A and B are the estimated coefficients on the age and MBA dummy from Equation (v). The results shows that the CEOs age is negatively related to leverage for both Pakistan and UK firms. This may indicate that older CEOs tend to take lower debts as they pursue conservative debt policies. However, business knowledge (as captured by MBA dummy) is negatively/positively related to leverage for UK/Pakistan. These results imply that having more

knowledge about the cost and benefits of leverage, an MBA qualified CEO may choose have high or low leverage depending upon the economic circumstances and institutional characteristics. The difference in results for Pakistan and UK can be explained in term of differences in cultures, economic conditions and institutional characteristics.

The coefficients on CEOs age (for dividend) are negative for UK and positive for Pakistan. Although, one may not truly provide a logical explanation for this relationship, conventional wisdom suggests that CEOs in higher age group in UK firms tend to avoid new equity issues and/or borrowing. Consequently they re-invest most of their earnings instead of distributing it as dividends. However, in case of Pakistan, most of the businesses are family owned therefore CEOs in such firms may prefer to pay more dividend.

The coefficients on CEOs age (for working capital) for both Pakistan and UK are negative. This again implies that with increase in age, CEOs become more conservative. The coefficients on MBA are also negative for both Pakistan and UK. The coefficients on CEOs age (for idiosyncratic risk and performance) are negative for both countries. This finding confirms the existing stance on CEOs age that old generation CEOs are likely to take low risk and consequently earn low return. The coefficients on MBA (for idiosyncratic risk and performance) are positive for both countries. This is in line [1], who show that the CEOs who hold MBA degree are associated with high operating returns.

Chapter 5

Conclusion and Policy Implication

5.1 Conclusion

Managers are responsible for guiding a firms organizational activities through financial and non-financial decisions. Their decisions thus lead an organization to operate successfully and achieve the objective of the shareholders wealth maximization which is often related to organizations profitability. Profitability is however, only one side of the coin, the other being the uncertainty (risk) caused by both internal and external factors. Thus the achievement of the key objective of organizations (shareholders wealth maximization) flows from the top management decisions, the profitability and the risk. Therefore, the role of top management, the decisions, and financial outcome become very important. Financial decisions influence the firms financial outcomes as well as the associated uncertainty caused by both internal and external factors. The responsibility of decision-making lies on the shoulders of top executives/managers and inevitably affects the value and performance of their respective organizations.

Although there is enough evidence in the literature to suggest that top managers are important for organizational policies and ultimately the success of organizations, studies are limited with respect to the scope and the subject matter. The existing literature in finance typically relies on managers fixed and firm level characteristics to explain financial policies [1], corporate leverage [12], corporate tax

avoidance [11] and voluntary corporate financial disclosure [10]. However, the role of individual top managers of firms in financial decisions, performance and idiosyncratic risk has been neglected in the literature. This study analyses the importance of the managerial dimension in explaining variations in the financial decisions, performance and idiosyncratic risk of firms in Pakistan and the UK. After accounting for both observable and unobservable heterogeneity, the observable differences in firms financing decisions, performance and idiosyncratic risk were identified which are attributable to managers fixed effects in Pakistan and the UK. In light of existing evidence, this study hypothesizes that top managers are important in explaining the cross sectional variation in strategic financial decisions (financing decision, working capital decision, and dividend pay-out decision), idiosyncratic risk and performance of the firm.

The results of the study show that top managers play a statistically significant and economically important incremental role in explaining financial decisions, performance and idiosyncratic risk. The study contributes to the finance literature by adding the dimension of financial styles of managers who moved from non-sharia compliant firms to sharia-compliant firms and managers who moved from sharia to sharia-compliant firms to explain financial decisions, performance and idiosyncratic risk. Results show that for managers who move from non-sharia to sharia-compliant firms there is a statistically significant difference between them in term of individual effects on financial decisions, performance and idiosyncratic risk. On the other hand, the managers who move from sharia to sharia-compliant firms are not different in terms of individual effects on financial decisions, performance and idiosyncratic risk. Since managers have significant individual effects on firms policies, performance and idiosyncratic risk.

This study also explores the impact of two observable characteristics of CEOs (age and business education) on the financial decisions, idiosyncratic risk and performance of the firm. The result show that the managers who belong to old age group are conservative in term of borrowing, dividend payment and risk taking. Accordingly, the performance of firms for aged CEOs is also lower. For CEOs holding an MBA degree, the results are mixed for Pakistani and UK samples.

The differences in results can be explained in terms of differences in economic conditions, educational levels and institutional characteristics. Overall, the results of this study are consistent with upper echelon theory [9] which suggest that the differences in the managerial decisions are due to difference in their personal value and cognitive styles. The results of the study oppose the view of strategic management theory.

5.2 Policy Implications and Limitations of the Study

The results of this study have important policy implications for shareholders who elect the directors, institutional investors who invest massive amounts in the shares of listed companies, and creditors who advance huge loans to large companies. Discerning the differences between the importance of the managerial financial styles of top officials in SC and NSC companies helps them make strategic plans in terms of their financial decisions. Investors can develop their tick-list of managerial financial styles for the companies in which they will be willing to invest. Similarly, shareholders are generally well advised to select those managers whose financial signature bears a close connection to the way those shareholders would like their company to be run. The present study is limited to identifying the differences, but what causes them is beyond its scope, and so could be another stage in future research.

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