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경영학석사 학위논문

Does CEO' s financial expertise affect
firm' s financial policies and firm value?

-Evidence from Korea

CEO의 재무전문성이 한국기업의 재무정책과
기업가치에 미치는 영향

2015년 2월

서울대학교 대학원
경영학과 재무금융전공
정슬기

Does CEO' s financial expertise affect
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지도 교수 김우진

이 논문을 경영학석사 학위논문으로 제출함

2014년 12월

서울대학교 대학원

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초 록

본 논문은 재무전문성을 보유한 CEO가 회사의 재무정책과 성과에 미치는 영향을 분석하였다. 재무전문성을 보유한 CEO가 경영하는 한국기업들은 그렇지 않은 기업들과 비교했을 때 현금보유량과 부채를 더 높게 가져가고 배당성향 또한 더 높은 것으로 확인되었다. 이러한 현상은 미국과 비교했을 때 한 가지 다른 점이 있다. 미국의 한 연구에 의하면 재무전문성을 미국기업들은 현금보유량을 더 낮게 가져가는 것으로 확인되었다. 이는 재무전문성을 보유한 CEO들이 자신의 Connection이나 노하우를 통해서 더 쉽게 자금을 조달할 수 있기 때문에 평상시에는 현금을 많이 보유할 필요성이 없기 때문이다. 한국에서는 기업문화가 좀 다르고 IMF의 영향 등으로 비추어 볼 때 경제상황에 대해 더 잘 알고 있는 재무전문가들이 경기침체를 예방하는 차원에서 현금을 많이 보유하는 방식으로 전체적으로 보수적으로 경영하려는 성향이 보인다. 이러한 현상을 설명하기 위해 재무전문성과 현금보유가 기업의 성과에 미치는 영향을 조사하였는데 실제로 재무전문성과 현금보유량 모두 기업성과에 유의미하게 양의 영향을 미치는 것으로 밝혀졌다. 이 결과에 비추어 볼 때, 한국에서는 재무전문성을 보유한 CEO들이 기업성과에 긍정적인 영향을 미치는 요소로 현금보유량을 더 높게 가져가는 것으로 해석할 수도 있다. 하지만 여기서 문제점은 CEO와 기업의 내생적인 matching이 이루어 질 수 있다는 점인데, 이는 실제로 CEO의 개인적 특성이 기업성과에 미치는 영향을 조사하는 많은 논문들 사이에서도 문제점으로 회자되는 부분이다. 이 문제점을 개선하기 위해서 필자는 몇 가지 분석을 통해서 이 내생적 matching이 결국에는 재무전문성을 보유한 CEO의 재무경영능력을 활용하기 위한 부분으로 우연이 아닌 필연적으로 matching된다는 점을 밝혔다. 다르게 표현하자면 대체로 KOSPI200에 포함되는 대기업들에 70%이상의 재무전문성을 보유한 CEO들이 몰려있는데 이 현상은 주로 mature firm들 즉 재무재표상 asset side보다는 financial side가 조금 더 중요한 기업들에 해당되는 것으로 보인다. 추가적인 조사내용을 살펴보면, 재무전문성을 보유한 CEO들은 경기침체 시에 재무전문성을 보유하지 않은 CEO들과 비교했을 때 다르게 반응하는 것을 볼 수 있는데 이 또한 재무전문성 자체가 가지는 영향력으로 해석하는데 도움이 된다.

하지만 이 논문은 비슷한 주제를 가진 기타 다른 논문들과 마찬가지로 내생적 matching의 문제점을 완벽하게 해결할 수 없음을 전제로 분석하였다.

주요어: 재무전문성, 재무정책, 기업성과, 현금보유량, 내생적 CEO-firm Matching

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1. Introduction

Several previous literature deals with the issue of CEO' s different management skills and personal characteristics affecting the corporate performance in different ways. Graham and Harvey(2001), Lins, Servaes, and Tufano(2010) and Lin, Ma, Officer and Zou(2011) all argue that CEOs actively manage their firms, especially they apply different criterions with regards to financial policies. Hence, it is worth to examine whether financial expert CEOs who are certainly more familiar with financial theories, rely more on the financial theories and pursue therefore their strategies in different ways compared to non-financial expert CEOs. Finally it is interesting to investigate the effect of the financial expertise of CEOs on the firm value, as it is in most cases the ultimate goal of every manager to maximize the firm value. Adams, Almeida, and Ferreira(2005), Bertrant and Schoar(2003), Brown, Liang, and Weisbenner and most recently Custodio and Metzger(2014) all deal with the managerial impact on financial policies. In particular, Custodio and Metzger(2014) show that CEOs with financial career background actively manage financial policies by holding less cash, more debt and engaging in more share repurchases. This paper contributes to the literature in the following ways: First, it shows that Custodio and Metzger(2014)' s results are not applicable to Korean firms. In Korea, firms with financial expert CEOs generally hold more cash, more debt, and engage in more dividend payout. In the later section, I will specifically attack each aspect. Second, the question about the different results in cash holdings might be answered through the analysis of the effect of CEO' s financial expertise on firm value by adding cash holdings as an explanatory variable. Indeed, the empirical research shows that cash

holdings have positive effect on the firm value proxied by Tobin's q . This result implies that financial expert CEOs hold more cash to increase the firm value. Third, it tries to handle the possibility that endogenous matching between CEOs and firms based on time-varying characteristics biases the results. My findings indicate that large firms like Chaebols generally hire more financial expert CEOs than smaller firms. It is to be shown if this is a coincidence or if there is a plausible explanation for this phenomenon.

I first show that an important fraction of CEOs, that is 38% of the CEOs, is financial expert CEOs. These are CEOs who have previous experience in the financial industry or in a financial role. As financial firms are excluded from the sample because of their specific regulations biasing the result, I find that nonfinancial firms headed by financial expert CEOs hold more cash on average. Furthermore, they are more leveraged and they tend to pay out more in terms of dividend payout or share repurchases. These findings are economically meaningful. Regression results indicate that cash holdings are about 2% higher and average leverage ratios are 2.3% higher. They are also 3.5% more likely to pay out dividends and 2.7% more likely to repurchase shares.

It is commonly accepted that cash-holding has negative effect on firm value. The question now rises why Korean firms with financial expert CEO holds more cash. Firms hold cash for many reasons, e.g. they hold it for precautionary motives, they hold it for payout policies like share repurchases, they just hold it because they cannot find a reasonable investment opportunities, or they use it for restructuring the ownership structure of the conglomerates etc. It is therefore of great importance to analyze first the effect of cash-holding and financial expertise of CEOs on the firm value of Korean firms. If these variables

are shown to increase the firm value, the phenomenon of more cash-holdings can be explained at least in Korea. Indeed, the regression result shows that both financial expertise of CEOs and cash-holdings have positive effect on firm value with statistical significance. Hence, this result implies that financial expert CEOs hold more cash than nonfinancial expert CEOs in order to increase the firm value.

In the literature on CEO characteristics it is commonly limited to interpret the results because of selection bias. The selection can bias the estimation of any potential effect on a CEO characteristic: First, there might be omitted variables on the CEO level. That is, financial expertise might be correlated with other CEO characteristics such as talent or education. However, this concern can be addressed by controlling for various variables on the CEO level using detailed biographical data. Another important issue is that endogenous CEO-firm matching could bias the results. For instance, certain firms that happen to have more cash and high leverage ratios might have preferences for financial expert CEOs. It is commonly accepted in the literature that this problem cannot be solved completely. However, this paper copes with this problem by exploiting within-firm variation and by controlling for firm fixed effects. Within-firm variation means that firms switch from a nonfinancial expert CEO to a financial expert CEO or vice versa. Under the assumption that the matching between CEOs and firms is based on time-varying unobservable characteristics such as optimal strategies of firms, the estimates of financial expertise might be biased. This might make it hard to single out the effect of financial expertise on her own. In other words, if these characteristics are time-invariant, the estimates of financial expertise can be interpreted as causal effects, and CEOs are believed to impose their styles on a company. I show that financial expert CEOs tend to be

appointed by mature firms, while non-financial experts tend to be appointed by firms in the growth stage of their life cycle. Hence, I intend to control for endogenous matching based on the life cycle of the firms by directly including further firm-level controls such as firm size and firm age.

The paper proceeds as follows. The next section describes data. Section 3 analyzes firm's financial policies by financial expert CEOs. Section 4 provides empirical explanation of the results of Section 3 by analyzing the effect of financial expertise of CEOs on firm value. Section 5 discusses alternative interpretations with emphasis on the matching between firms and CEOs. Section 6 concludes.

2. Data description

This section describes the data sources and presents main summary statistics.

2.1. Data

My data collecting process is based on two phases. First, I collect manually personal characteristics of CEOs of firms listed in KOSPI from 2000 to 2013. I use four data sources for this phase: Dataguide to get the initial CEO list, Naver Person Search System to get the personal characteristics of CEOs, Korea CEO yearbook and finally Maekyung Yearbook to collect additional data. In the second phase, I merge this CEO-firm panel with firm characteristics which are available in Dataguide. I exclude firms from financial sector because they are under strict regulations from the Financial Supervisory Service and are therefore limited to change their financial policies easily. Furthermore, I exclude firms with no data available in Dataguide. Together, I have 5514 CEO-firm-year. All variable definitions are reported in Table 1.

Table 1
Variable definitions.

Panel A: CEO characteristics	
Variable	Definition
CEO age	Age of CEO in years
CEO tenure	Number of years as CEO in the current position
CEO-chair dummy	Dummy variable that equals one if the CEO is also chairman of the board
Econ dummy	Dummy variable equal to one if the CEO has an economic-related degree, and zero otherwise
External hire dummy	Dummy variable that takes the value of 1 if the CEO is hired externally
Fast track CEO	Age at which CEO became CEO for the first time
Financial expert CEO	CEO who has past experience in either banking or investment firms, in a finance-related role or in an auditing firm
Sky league alumnus	Graduated from Seoul national university, Yonsei university, Korea university
Law dummy	Dummy variable that equals one if CEO has a law-related degree, and zero otherwise
MBA dummy	Dummy variable that takes the value of one if CEO has an MBA degree, and zero otherwise
Recession graduate	Graduated during recession year
Science dummy	Dummy equal to one if CEO has a science-related degree, and zero otherwise
Sex dummy	Dummy variable equals one if the CEO is male
Panel B: Firm characteristics	
Assets	Book value of total assets
Asset growth	Book value of assets in year t over book value of assets in year t-1 minus one
Asset volatility	Standard deviation of stock return during the fiscal year times market value of equity divided market value of assets
Book Leverage	Ratio of total debt to book value of assets
Capex	Ratio of capital expenditures to book value of assets
Cash	Ratio of cash and short-term investments over book value of total assets
Dividend dummy	Dummy variable that takes the value of one if the firm pays dividends, and zero otherwise
Firm age	Number of years between establishment year and fiscal year
Firm size	measured by Log(Assets)
Net working capital	Net current assets minus cash divided by assets minus cash
PPE	Ratio of net property, plant and equipment to book value of assets
R&D	Ratio of research and development expenditures to book value of assets
Repurchase dummy	Dummy variable equals to one if the firm buys back shares in a given year
Retained earnings	Ratio of retained earnings to common equity
ROA	Ratio of EBITDA to book value of assets
Sales	Sales
Tobin' q	Measured by the ratio of market value of assets to book value of assets
Panel C: Market variables	
Default spread	Difference between the yearly average yield on Kistrating's corporate bond ratings AAA and B

2.2 CEO and firm characteristics.

Table 2, Panel A shows descriptive statistics for the financial expertise of CEOs in my panel. 38.2% of CEOs in my sample are financial expert CEOs who have previous work experience either in the financial industry or in a financial role in a nonfinancial firm. I define a financial expert as a CEO who has past experience in either banking or investment firms, or in a finance-related role (accountant CFO, treasurer, or VP of finance), or in a large auditing firm. In details, 9% of CEOs have work experience in depository institutions like banks. 8% of CEOs have worked in non-depository institutions like credit card company or insurance company, 6% in investment firms, less than 1% in auditing firms and 13.8% have been in the position with financial role. Panel B provides descriptive statistics for the CEOs in our panel. Except 3 female CEOs(0.001%), all the other CEOs are male. The CEOs are in average 57 years old, and have been in the company for 9 years. Approximately 60% of the panel has some level of financial education, e.g. an MBA, or an economics-related degree (undergraduate, masters, or doctorate). Table 2, Panel B shows other average observable characteristics of financial expert and nonfinancial expert CEOs in terms of education and career path. The variables fast track CEO, Sky League alumnus are proxies for innate talent, following Falato, Li, and Melbourn (2012) and Custodio, Ferreira, and Matos (2013). Financial expert CEOs differ from non-financial expert CEOs almost in all investigated aspects. Nonfinancial expert CEOs are more likely to have a science degree (31% vs. 8%), and they tend to be in the company about 1 year longer than financial expert CEOs (9% vs. 8%). Financial expert CEOs are more likely to some level of financial education including MBA and economics-related degree (76% vs. 50%).

They possess higher innate talent, that is, they are more likely to have graduated from a Sky league school (64% vs. 46%), and they became CEOs for the first time about 1 year younger than nonfinancial expert CEOs (46.6 vs. 47.4). In my regression analysis, I control for these proxies of general skills and talent, as well as age and education. Bertrand and Schoar (2003), and Malmendier and Tate (2005) show that age and having MBA or other type of financial education are associated with CEO style and with firm financial policies.

Table 2, Panel C shows descriptive statistics for firms in my panel. Firms with financial expert CEOs tend to hold more cash, more leverage and to engage more in dividend payout. Furthermore, these firms have more assets, higher Tobin's q and lower asset volatility.

Table2

The sample consists of DataGuide firms for which CEO profile data are available from various other data sources in the 2000–2013 period. All variables are winsorized at the 1% and 99% values. Variable definitions are as defined in Table 1. ***p<0.001, **p<0.05, *p<0.1.

Panel A: CEO financial expertise						
	Mean	sd	N			
Financial expert dummy	0.382	0.475	5178			
Depository institutions	0.088	0.346	5178			
Nondep. Institutions	0.082	0.314	5178			
Investment banks	0.063	0.284	5178			
Auditing experience	0.011	0.212	5178			
Financial Role	0.138	0.354	5178			
Panel B: CEO characteristics						
	Mean	sd	N	Financial expert CEO	Nonfinancial expert CEO	Diff.
CEO age	56.891	8.723	5178	56.477	57.105	-0.628**
Sex dummy	0.999	0.079	5178	0.998	0.990	0.008***
CEO tenure	8.856	8.766	5178	8.164	9.204	-1.039***
MBA dummy	0.154	0.216	5178	0.161	0.112	0.078***
Econ dummy	0.598	0.492	5178	0.759	0.497	0.262***
Science dummy	0.233	0.420	5178	0.076	0.307	-0.231***
Law dummy	0.094	0.244	5178	0.094	0.046	0.047***
Sky dummy	0.526	0.499	5178	0.636	0.464	0.172***
Fast track CEO	46.912	9.356	5178	46.659	47.398	-0.739***

Panel C: Firm characteristics

	Mean	sd	N	Financial expert CEO	Nonfinancial expert CEO	Diff.
Cash	0.062	0.074	5178	0.082	0.043	0.039***
Book leverage	0.516	0.209	5178	0.565	0.483	0.081***
Dividend dummy	0.720	0.452	5178	0.756	0.638	0.117***
Share repurchase dummy	0.712	0.453	5178	0.717	0.708	0.008
Assets	5.716	0.775	5178	5.979	5.576	0.402***
Tobin' s q	0.963	0.534	5178	0.975	0.956	0.019*
ROA	0.032	0.083	5178	0.030	0.033	-0.003
Asset volatility	0.012	0.009	5178	0.010	0.013	-0.002***
Firm age	36.000	21.174	5178	39.254	32.457	6.797***
Capex	0.038	0.058	5178	0.031	0.041	-0.009***
R&D	0.006	0.014	5178	0.003	0.007	-0.003***
Asset growth	0.158	0.892	5178	0.098	0.272	-0.174
Net working capital	0.144	0.153	5178	0.109	0.161	-0.052***

3. Financial expertise of CEOs and financial policies.

In the literature, the frequently mentioned variables of firm financial policy are cash holdings, leverage, and payout policy. Therefore, I focus on these variables to examine the relation between firm financial policy and the financial expertise of CEO. The process looks as follows: I run panel regressions on the determinants of cash holdings, leverage, dividend payout, and share repurchases in which the main independent variable of interest is a financial expert CEO dummy.

Table 3 shows the results of OLS regressions with cash and leverage, as dependent variables from columns 1 to 4 and the results of Probit regressions with dividend dummy and share repurchase dummy as dependent variables from columns 5 to 8. After controlling for various variables, I find out that financial expert CEOs tend to hold more cash, more debt and more dividend. As for repurchase dummy, It seems to have no significant relation with financial expert dummy. This result

is consistent with Custodio and Metzger(2014) except for cash-holdings that in Korea firms with financial expert CEO generally hold more cash.

Columns 1 and 2 of Table 3 provide answer to the question whether financial expert CEOs follow different strategies with regards of firm's cash holding policies. I run ordinary least squares (OLS) and firm fixed effects regressions in which the dependent variable is the logarithm of cash holdings, that is, the logarithm of the ratio of cash and marketable securities to non-cash assets. The OLS regression includes interacted industry and year fixed effects. The firm fixed effects regressions also include year fixed effects. Various firm characteristics, typically used as determinants of cash holdings¹, are used as control variables. The result shows that cash is positively related to the size of the firm, proxied by the logarithm of assets, Tobin's q, asset volatility and leverage, and negatively related to R&D, Capex and networking capital. This result is somehow mixed and is only partly consistent with Opler, Pinkowitz, Stulz, and Williamson (1999) and Bates, Kahle, and Stulz (2009). However, it implies that Korean large firms with less investment opportunities tend to hold more cash, and cash holdings generally increases the firm value.

In column 1 I run a cash holding regression in which I add the financial expert CEO dummy and other CEO characteristics such as age and tenure. In column 2 I extend the regression and run a similar specification with firm fixed effects relying on within-firm variation and with multiple other control variables of personal characteristics. Within-firm variation means that the identification comes from cases

¹ See Opler, Pinkowitz, Stulz, and Williamson (1999); Harford, Mansi, and Maxwell (2008)

in which a firm switches from a nonfinancial expert CEO to a financial expert CEO or vice versa. A financial expert CEO holds about 1% more cash than a nonfinancial expert CEO. The coefficient of the financial expert CEO dummy is statistically significant at the 1% level in the OLS regression and in the firm fixed effects specifications. Bates, Kahle, and Stulz (2009) argue that the trend of increasing corporate cash holdings over the last decades is mainly driven by the precautionary motive for holding cash. In general, the evidence is consistent with firms holding cash for precautionary motives: Financial expert CEOs are more aware of economic change and danger of financial crisis and hold more cash to prepare for sudden break down of financial economy like the subprime mortgage crisis in 2007.

Columns 3 and 4 of Table 3 show the results of regression tests of leverage on the financial expertise of the CEO. The dependent variable leverage is measured by the ratio of total debt to the book value of assets. I run an OLS regression with interacted industry and year dummies and firm fixed effects regressions with year dummies. In both regressions, t-statistics are adjusted for heteroskedasticity and within-firm correlations using clustered standard errors. The set of controls include firm size measured by the logarithm of assets' book value, Tobin's q as a measure of investment opportunities, the volatility of assets, research and development costs (R&D) as a proxy for intangibility, capital expenditures, a dummy variable for dividend-paying firms², profitability measured by return of assets(ROA), and the tangibility of the assets measured by the ratio of property, plants, and equipment(PPE) to total assets. I find leverage for the firms in our

² See Hovakimian, Opler, and Titman (2001); Lemmon, Roberts, and Zender (2008)

sample to be positively related with firm size and Tobin's q. Tenure, asset volatility, R&D, dividend dummy, ROA and PPE are all negatively associated with leverage. The estimates are mostly consistent with the results in Lemmon, Roberts, and Zender (2008). The differences might be explained by differences in the samples. The estimated coefficient for the financial expertise of the CEO is positive, which suggests that firms with this type of CEO tend to hold more debt. The impact of having a financial expert CEO on leverage is about 1.2 percentage points in the firm fixed effects regressions. This corresponds to 2.3% more leverage in relative terms for an average firm.

Column 5 and 6 of Table 3 show the regression results of a linear probability model (LPM) of dividend payout on a financial expert CEO dummy and other CEO and firm-level controls. CEO-level control variables include age, tenure, education and talent, proxied by MBA dummy, Sky league alumnus and Fast track CEO. Firm-level controls include firm size, ROA, leverage, previous year dividend payout, asset growth, and cash.³ I find a positive and significant coefficient of financial expertise in specification (5) and (6). The point estimate is 2.5% corresponding to 3.5% higher likelihood of paying out dividends on average. When firm fixed effects are included, there is no difference. This suggests that the differences between financial expert and nonfinancial expert CEOs in terms of dividend payout policy are mainly driven by time-invariant firm characteristics that are omitted. This is consistent with the view that dividend payout decisions are quite stable over time and do not require much financial knowledge and sophistication.

Columns 7 and 8 of Table 3 show regression results for share

³ See DeAngelo, DeAngelo, and Stulz (2006)

repurchases. The dependent variable in all regressions is a dummy variable which equals one if the firm buys back shares in a given year. Firm-level controls include firm size, lagged share repurchase dummy, leverage, profitability, cash, and asset growth. I find similar results across all specifications. Firms with financial expert CEOs tend to engage more in share repurchases, controlling for the typical determinants of payout policy. Financial expert CEOs have a 0.5 percentage point higher propensity to buy back shares, which corresponds to 2.7% higher likelihood, on average, in relative terms. All in all, the results are consistent with the idea that financial expert CEOs follow different financial policies. The fact that the financial expert CEOs in Korea hold more cash and that this results differ from Custodio and Metzger (2014) let us think about the reason. It is to be tested whether this difference stems from different economic environment or is in most extreme cases just a coincidence. With the assumption of no agency problems in the ownership structure of a firm, it is commonly accepted that CEO tries to maximize the firm value. If financially more sophisticated CEOs hold more cash to increase the firm value, a hypothesis we test below, the phenomenon above may be explained.

Table3

The dependent variable in regressions (1)–(2) is the log of cash and marketable securities. The dependent variable in regressions (3)–(4) is the ratio of total debt to assets. The dependent variable in regressions (5)–(6) is a dummy variable which equals one if the firm paid a dividend in the current year. The dependent variable in regressions (7)–(8) is a dummy variable equal to one if the firm repurchased shares in the current year. Variable definitions are as defined in Table 1. ***p<0.01, **p<0.05, *p<0.1.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Cash		Leverage		Dividends		Repurchases	
Financial expert CEO	0.018***	0.017***	0.011***	0.012**	0.023**	0.025*	0.014*	0.015*
Age	-0.000**	-0.000**	0.001**	0.001	0.000	0.000	-0.001	-0.002
Tenure	0.000***	0.000***	-0.001***	-0.001***	0.003***	0.003***	0.001	0.002*
Log(assets)	0.002***	0.002***	0.054***	0.064***	0.029***	0.028***	0.047***	0.047***
Tobin's q	0.017***	0.013***	0.101***	0.089***				
Asset volatility	0.464***	0.372***	-1.816***	-1.101***				
R&D	-0.053	-0.202***	-1.211***	-1.028***				
Capex	-0.153***	-0.212***	0.051	-0.043				
Dividend	-0.007***	-0.041***	-0.116***	-0.122***				
ROA			-0.539***	-0.011***	0.937***	0.933***	-0.104**	-0.106**
PPE			-0.060***	-0.045***				
Leverage	0.085**	0.085***			-0.309**	-0.309***	-0.068**	-0.069**
Cash flow	0.000	0.002***						
Net working capital	-0.075**	-0.109***						
Dividend dummy (t-1)					0.590***	0.589***		
Repurchase dummy (t-1)							0.724***	0.722***
Asset growth					-0.001	-0.001	0.000	0.000
Cash					-0.388**	-0.389***	-0.017	-0.016
MBA		-0.007		-0.013		0.028		0.010
Econ		0.001		0.018*		0.004		0.001
Science		0.001		0.019		0.008		0.001
Law		-0.014*		0.036		0.002		0.021*
Sky League alumnus		0.000		-0.011*		-0.003*		-0.004
Fast track CEO		0.000**		0.000		0.001		0.001**
Obs	5178	3654	5178	3654	5178	3654	5178	3654
Industry dummies	Yes	No	Yes	No	Yes	No	Yes	No
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm fixed effects	No	Yes	No	Yes	No	Yes	No	Yes
R-squared	0.398	0.604	0.509	0.512	0.551	0.552	0.543	0.547

4. Financial expert CEOs and firm value

Next, we look at the valuation effects of different CEOs. Assuming that it is beneficial for a firm to appoint a financial expert CEO, if some of the other firms do not do it (or cannot do it), we should be able to observe a positive effect on performance. Furthermore, we go one step further and test the hypothesis that firms with financial expert CEOs hold more cash to increase the firm value. CEO-level controls include age, tenure, Fast Track CEO, Externally hired CEO and CEO-chairman dummy. Firm-level controls include firm age, asset growth, firm size, leverage, PPE, Capex, R&D and cash⁴.

Table 4 shows the results of the tests. The dependent variable in all regressions is Tobin's q . The independent variables of interest are the financial expert dummy and cash holdings. Both regressions include year-fixed effects and firm fixed effects.

We find a negative effect of PPE and age on firm performance whereby the estimated coefficients of PPE are statistically not significant. All the other control variables have positive effect on firm performance.

We find a positive effect of both financial expert dummy and cash holding on firm value. This result implies that firms may hire financial expert CEO who tends to hold more cash and increases the firm value. This interpretation of results, however, faces some limitations. The concern about endogenous matching is still not solved and there might be omitted variables to emphasize the economic meaning of this result. Restricted to our sample, however, the result is quite meaningful as the result implies that holding more cash by financial expert CEOs is one of the financial methods to do their works (increase the firm value).

⁴ See Villalonga and Amit (2006); Custodio and Metzger (2014)

Table 4

The dependent variable in both regressions is Tobin's q, as a proxy for firm performance. Variable definitions are as defined in Table 1. ***p<0.01, **p<0.05, *p<0.1.

	Tobin's q	Industry adjusted Tobin's q
Financial expert CEO	0.039**	0.029**
Cash	1.154***	1.012***
Firm age	0.016*	0.029*
Asset growth	0.084***	0.112**
Log(assets)	0.069***	0.023***
Leverage	0.284***	0.345***
PPE	-0.043	-0.041
Capex	0.883***	0.541***
R&D	8.827***	7.042***
Age	-0.007***	-0.004**
Tenure	0.001	0.000
External hire CEO	0.059***	0.023**
First year CEO	0.002*	0.001
CEO-chairman dummy	0.077***	0.098***
Obs	5178	5178
Year dummies	Yes	Yes
Firm fixed effects	Yes	Yes
R-squared	0.364	0.227

5. Limitation of interpretation

I follow the majority of the literature in our primary analysis by exploiting firm fixed effects which relies on within-firm variation in estimating CEO effects. The results suggest a causal effect of financial expertise on firm policies and firm value. However, the interpretation of the results faces a common limitation and is not straightforward. There are at least two ways in our analysis that the selection can bias the effect of financial expertise of CEOs on firm policies and firm value: The measure of financial expertise might be correlated with

some omitted independent variables which would bias the results. In this section we discuss the possibility of endogeneity in CEO-firm matching.

5.1. Unobserved CEO heterogeneity

As mentioned above, financial expertise of CEOs might be correlated with other omitted variables on CEO-level. For instance, financial expert CEOs might have other characteristics like education, talent, or different management skills that drive my findings. This concern is alleviated by controlling for various extra variables from our data set which contains detailed biographical information including educational background and employment history. This allows me to include additional controls: I add age, tenure, gender, a set of education dummies controlling for educational background (MBA, economics, science, law), as well as some proxies for the talent of the CEO (Sky League alumnus, fast track CEO). In all the tests of this paper I control for CEO characteristics to alleviate the concern that financial expertise could be proxying for these. There is still a concern remaining that the financial expertise of CEOs might be correlated with some variables not included in the data set or not observable.

5.2. Endogenous CEO-firm matching

A second and more severe concern is that endogenous matching between CEOs and firms is driving my results. It would be the case, for instance, that high cash holding firms might have preference for financial expert CEOs so that assortative matching between financial experts and high cash holding firms based on preference explains our

findings. Within-firm variation, which the primary analysis relies on, is indeed a valid way to deal with endogeneity problems under the assumption that the matching between CEOs and firms is based on time-invariant unobservable characteristics. In that case, the estimates of financial expertise can be interpreted as causal effects, and conclude that CEOs impose their particular style on a company. However, if the unobservable characteristics like strategies of a company changes over time, a CEO might rather be chosen by that company because of her attributes.⁵

The descriptive statistics in Table 2 provide average firm characteristics for firms with and without a financial expert CEO. Firms with financial expert CEOs are about 6.8 years older, on average, and they are bigger in size, proxied by the logarithm of assets, than firms without a financial expert CEO, 5.97 billion won and 5.47 billion won, respectively. Firms with financial expert CEOs tend to spend about 50% less in research and development, and we can observe less asset volatility compared to firms with nonfinancial expert CEOs. Table 2 Panel C also shows the correlation between firm characteristics and the financial expertise of the CEO.

The observed, statistically significant differences between those two groups suggest that the matching of CEO and firm is closely related to a firm's life cycle. In other words, it seems that the demand for financial expertise in a CEO is linked to the firm's life cycle, as I find that the firms with financial expert CEOs tend to be older and larger, invest less in R&D, and have lower asset volatility and asset growth. All these characteristics are associated with firms that are at a mature stage in their life cycle. Indeed, an untabulated analysis⁶

⁵ See Bertrand and Schoar (2003); Fee, Hadlock, and Pierce (2013)

⁶ We add the so-called adjusted KOSPI200 dummy to our analysis and we find that almost 70% of

finds that firms with financial expert CEOs are mainly firms that are at a mature stage in their life cycle. Firms in the growth stage of its life cycle usually is more focused on the asset side, evaluating growth opportunities and projects, investing, and growing its assets. In a more mature stage the firm turns its focus to the financing side of the balance sheet, minimizing the cost of capital and paying out to shareholders while making sure it has enough financial resources to run its operations. This phenomenon implies that a different type of CEO might be needed for firms at different stages of their life cycle. We conjecture that a financial expert CEO could be optimal for firms in a more mature stage, while a more entrepreneurial CEO could be better for firms in a growth stage. For sure, it does not indicate, however, that financial expert CEOs are not valuable or wanted by growth firms as well, it just implies that other skills might be relatively more appropriate.

In Table 5 I analyze matching CEOs and firms employing a multivariate setup. To test whether firms that hire financial expert CEOs and firms that hire nonfinancial expert CEOs are different, I analyze firm characteristics at the time they hire a new CEO. In specifications (1)–(8) we restrict our sample to the last year of tenure of a CEO. That is, we look at years that are followed by a CEO turnover. When I restrict the analysis to firms with a CEO turnover, I lose of 90% of the observations, and the tests have less power. The point estimates, however, remain the same in terms of sign and magnitude, as compared to the previous tests. The coefficient on retained earnings remains insignificant. The dependent variable in specifications (1)–(8) is a dummy variable that is equal to one if the new CEO is a financial expert and zero otherwise. This enables me to examine which firm

financial expert CEOs is hired by the firms listed in KOSPI200.

tends to have preference for financial expert CEOs. The results are consistent with the univariate analysis. Firms that are larger, have fewer investment opportunities, and less volatile assets, are older, and have more retained earnings are more likely to have financial expert CEO. All these characteristics are typical of firms that are not in a growth stage of their life cycle. In columns 8 I include all the characteristics simultaneously. The correlation still holds except for the variable asset growth which becomes statistically insignificant.

Overall, these results support the idea of an assortative match of CEOs with different levels of financial expertise of firms at different stages of their life cycle. In specification (9) we include all firm-years. The dependent variable is a dummy that is equal to one if the current CEO is a financial expert. Here I find again that financial expert CEOs are, on average, employed at firms that are larger, have lower total investments, and lower asset volatility, are older, and experience less asset growth.

The finding that financial expert CEOs tend to be matched to firms in more mature stages is important as random matching between CEOs and firms is an implicit identifying assumption in many research papers on CEO characteristics and their influence on firm performance. In our case, the findings are consistent with “financial skills view”.⁷ This view implies that it is financial expert CEO who implements a given financial policy. This contradicts “no financial skills view” under which CEOs do not matter. For instance, financial expert CEOs could have an idiosyncratic preference for specific financial policies, and firms employ CEOs with the preferences to match their life cycle stage or their business model. In this case, it is firms not CEOs who

⁷ See Custodio and Metzger (2014)

are responsible for the observed firm policies.

It is not easy to distinguish between these two views. This problem can be solved if a random matching of CEOs to firms at different stages in their life cycle is possible, e.g. allocate a nonfinancial expert CEO to a mature firm. This experiment is, however, not possible, and thus we need to assume that there are some frictions in the matching between CEOs and firms. In other words, the matching is not optimal at all times. In reality this assumption is indeed not implausible: Labor markets for executives are very restrictive and firms do not change CEOs that often. Even very high percentage of firms that are family firms are managed by the family itself and do change the CEO at all. We present further evidence that is mainly consistent with a “financial skills view” interpretation of our findings in the following sections.

Table 5

Specifications 1-8 analyze turnovers only and the sample is restricted to firm-year observations of turnover years, i.e. includes only firm-year before replacement of CEO in the next year. The dependent variable in regressions 1-8 is a dummy equal to one if the incoming CEO is a financial expert. Specification 9 analyzes all firm-years. The dependent variable is a dummy variable that is equal to one if the current CEO is a financial expert CEO. Variable definitions are as defined in Table 1. ***p<0.01, **p<0.05, *p<0.1.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Incoming CEO is financial expert I conditional of a turnover in t+1							Financial expert	
Log(assets)	0.012***							0.008***	0.043***
Capex		-0.233***						-0.189***	-0.231***
Log q			0.002					0.008	0.004
Asset volatility				-0.054***				-0.124***	-0.088***
Firm age					0.124***			0.113***	0.147***
Asset growth						-0.014*		-0.007	-0.011*
Retained earnings							0.001	0.001	-0.004
Obs	542	542	542	542	542	542	542	542	5178
Sample	Turnover	Turnover	Turnover	Turnover	Turnover	Turnover	Turnover	Turnover	Full
Industry × Year dummies	No	No	No	No	No	No	No	Yes	Yes
R-squared	0.041	0.007	0.001	0.009	0.017	0.001	0.000	0.219	0.177

5.2.1 Financial expert CEOs and firm life cycle

So far I have discussed about the possibility that the matching between financial expert CEOs and firms is related to the life cycle of the firm. We conjecture that controlling for the life cycle will help me estimate the causal effect of financial expertise. This strategy allows me indeed to exploit variation within the life cycle of a firm by estimating the difference in cash holdings of mature firms that are run by financial expert CEOs and nonfinancial expert for instance. Therefore, I add firm size, asset volatility, firm age, total investments, asset growth, and retained earnings as proxies for the life cycle to our standard specifications. As it is plausible that the life cycles of firms within the same industry are correlated, I include industry interacted with year dummies in our regressions.

Adding these controls attempts to address the possibility that financial expertise might be capturing only the effects of firm life cycle, given that these CEOs tend to be matched to more mature firms. The following analysis relies on the identifying assumption that the matching between firms and financial expert CEOs is based on these characteristics, and the matching between CEOs and firms is not perfect all the time.

Table 6 reports the results. They are very similar in terms of magnitude as the findings in Table 3, except for the smaller significance. These results support the “financial skills view” interpretation of the findings.

Table 6

In these regressions we explicitly control for the life cycle of the firm by including size, asset volatility, firm age, total investments, asset growth, retained earnings, and by including industry \times year dummies accounting for the fact that the life cycle of the industry is a proxy for the life cycle of the firm. The dependent variable in regression (1) is the log of cash and marketable securities. The dependent variable in regression (2) is the ratio of total debt to assets. The dependent variable in regression (3) is a dummy variable equal to one if the firm paid a dividend in the current year. The dependent variable in regression (4) is a dummy variable equal to 1 if the firm repurchased shares in the current year. Year dummies are included in all regressions. Variable definitions are as defined in Table 1. ***p<0.01, **p<0.05, *p<0.1.

	(1)	(2)	(3)	(4)
	Cash	Leverage	Dividends	Repurchases
Financial expert CEO	0.004**	0.006*	0.002	0.073*
Age	-0.004	0.003	0.002	0.017
Tenure	0.001*	-0.000	-0.030***	-0.016***
Log(assets)	0.003***	0.051***	-0.488***	-0.363***
Tobin's q	0.016***	0.087***	0.278***	-0.198***
Asset volatility	0.410***	-1.639***	2.522***	1.132**
Dividend	-0.002	-0.105***		
ROA			-1.834***	0.342
Leverage	0.088***		2.679***	0.368***
Cash flow	-0.007*			
Net working capital	-0.064***			
Dividend dummy(t-1)			0.874***	
Repurchase dummy(t-1)				0.147***
Cash			0.042***	0.304*
MBA	0.010	-0.002	-0.548	-0.149
Econ	0.007	0.004	-0.174**	0.004
Science	0.005	0.001	-0.045	-0.087
Law	0.002	0.031*	-0.290*	-0.302
Sky League alumnus	0.004**	-0.004	0.113**	0.037
Fast track CEO	0.001	0.002	-0.012	-0.011*
Firm age	0.009	-0.003*	0.005	-0.008*
Total investments	-1.017**	-0.017*	0.078*	0.009
Asset growth	0.034***	0.038**	-0.143**	0.032
Retained earnings	0.008	-0.018***	-0.787***	-0.037
Obs	5178	5178	5178	5178
Industry \times Year dummies	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
R-squared	0.304	0.459	0.244	0.278

5.2.2. CEO-firm matching and firm performance

In this section I look at the valuation effects of different CEOs at different stages of a firm's life cycle. Under the "no financial skills view" the identity of the CEO is not expected to matter. However, under the "financial skills view" there might be valuation implications if there are some frictions in the labor markets for CEOs. Under the assumption that it is beneficial for a more mature firm to appoint a financial expert CEO, if some of the less mature firms do not do it, we should find a positive effect on performance of interaction between the financial expertise of the CEO and mature firms. Columns 1 and 2 of Table 7 show the results of the tests. The dependent variable in all regressions is Tobin's q. The independent variable of interest is the interaction between the financial expert dummy and asset growth and between the financial expert dummy and firm age. Interaction between financial expert dummy and asset growth is negatively related to the firm performance. This result suggests that firm resources in mature firms are appropriate for the financial expertise of the CEO, consistent with the "financial skills view". Furthermore, I find a positive effect for the interaction between financial expertise and firm age, when I use firm age as a proxy for matureness of a firm.

Table 7

Columns 1 and 2 show the effect of firm age and financial expertise of the CEO on firm performance. The dependent variable in all regressions is the log of q. CEO and firm variables are as defined in Table 1. ***p<0.01, **p<0.05, *p<0.1.

	(1)	(2)
	Tobin's q	
Financial expert CEO × Asset growth	-0.109**	
Financial expert CEO × Firm age		0.002*
Financial expert CEO	0.053***	0.102***
Firm age	-0.004***	-0.003***
Asset growth	0.136***	
Log(assets)	0.073***	0.074***
Leverage	0.182***	0.191***
PPE	-0.134**	-0.158***
Capex	0.787***	0.856***
R&D	0.885***	0.887***
Age	-0.007	-0.008
Tenure	-0.002	0.002
External hired CEO	0.059**	0.060***
First year CEO	0.002	0.003*
CEO-chairman dummy	0.084***	0.087***
Obs	5178	5178
Industry × Year dummies	Yes	Yes
Firm fixed effects	Yes	Yes
R-squared	0.512	0.413

5.2.3. Reaction to shocks to overall credit conditions.

In order to strengthen the “financial skills view” I analyze the financial policies from a dynamic perspective: I test whether financial expert CEOs react differently to changes in the market environment and whether they manage financial policies more actively in different situations. For this purpose, I exploit exogenous variation in overall credit conditions for firms, measured by the default spread. Default spread is the difference between the yearly average yield on

Kisrating' s corporate bond ratings AAA and B.⁸ Table 8 reports the results of regressing cash holdings on the default spread and interaction of the default spread with the financial expert dummy. Firm-level control variables in these regressions are the same as the ones in Table 3.

The main independent variable of interest is the interaction term of the default spread and the financial expert CEO dummy. The coefficient of this interaction is positive and statistically significant at the 5% level in column 1 and 2. This result implies that financial expert CEOs actively manages financial policies by increasing cash holdings when external markets make it difficult to raise cash. This result is also consistent with Almeida, Campello, and Weisbach (2004) and Bates, Kahle, and Stulz (2009) who find evidence of a precautionary motive for cash holdings.

This finding alone cannot reject the hypothesis that the increase in cash holdings when the default spread is high comes from internally generated funds that are retained in the firm. Therefore, we exploit another analysis to find out whether financial expert CEOs are able to issue debt when the default spread is high.

Specifications (3) to (4) in Table 8 test whether financial expert CEOs are better able to raise debt when it is more difficult to get access to credit. A limited probability model includes the same firm-level controls as in Table 3. The dependent variable in specifications (3) and (4) is a dummy variable equal to one if the firm issues debt in a given year. The debt issues are obtained from Kisrating. The main variable of interest is interaction of the default spread with financial expert dummy. The coefficient of this interacted variable is positive

⁸ If shocks to credit conditions, measured by the default spread, are unexpected by firms, the matching between CEOs and firms could be exogenous to this shock.

and significant at the 10% level in both specifications with and without firm fixed effects.

The fact that financial expert CEOs hold more cash and are not so constrained in accessing debt markets in periods of high default spreads suggests benefits associated with financial expertise. This is also closely related to the CEO professional experience. It might be that financial expert CEOs have better access to a financial network and to financing providers, a hypothesis which should be tested in further research.

Overall the results in this section imply that financial expert CEOs follow more dynamic financial policies and actively exploit their financial skills, which in turn supports the “financial skills view” interpretation.

Table 8

The dependent variable in columns 1 and 2 is the log of cash to assets. The dependent variable in columns 3 and 4 is a dummy variable equal to one if the firm issues debt in a given year. All regressions include industry and year dummies. Variable definitions are as defined in Table 1. ***p<0.01, **p<0.05, *p<0.1.

	(1)	(2)	(3)	(4)
	Cash holdings		Debt issues	
Financial expert CEO × Default spread	0.016**	0.017**	0.074*	0.045*
Financial expert CEO	0.003**	0.009**	-0.007	-0.002
Age	-0.002	-0.012	0.000	0.001
Tenure	0.005*	0.007*	0.003	0.008
Log(assets)	0.035**	0.049***	0.144***	0.119***
Log q	0.018***	0.012***		
Leverage	-0.089***	-0.055***		
Cash flow	-0.034***	-0.004**		
Asset volatility	0.427***	-0.101***	-0.057***	-0.023**
Net working capital	-0.067***	-0.098***		
R&D	-0.026*	-0.103		
Capex	-0.139***	-0.059***	0.742***	0.545***
Dividend dummy	-0.035	0.203		
MBA		0.024		-0.001
Econ		-0.012		0.005
Science		-0.005		0.012
Law		0.001		0.007
Sky League alumnus		0.009		-0.017
Fast track CEO		0.021		0.000
Asset growth				
Obs	5178	3654	5178	3654
Industry dummies	Yes	No	Yes	No
Year dummies	Yes	Yes	Yes	Yes
Firm fixed effects	No	Yes	No	Yes
R-squared	0.314	0.558	0.112	0.208

6. Conclusion

My analysis provides empirical evidence that Korean nonfinancial firms headed by financial expert CEO hold more cash on average. Furthermore, they are more leveraged and they have a higher propensity than firms without financial expert CEOs to pay out money to shareholders.

The difference of this result compared to Custodio and Metzger (2014), which examines virtually the same aspect to US firms, is explained by the findings that financial expert CEOs in Korean firms hold more cash to increase the firm value. Both financial expertise of CEO and cash holding have positive effect on firm performance. However, a common limitation in the literature on CEO characteristics is interpretation of the results. In my case, there are at least two ways that selection biases the estimation of any potential effect of CEO characteristics such as financial expertise on firm decision making. First, there might be omitted variables on the CEO level. This concern is alleviated by controlling for various variables of personal characteristics from the data set which contains a set of detailed biographical information such as education and talent. There is also concern that endogenous CEO-firm matching could bias the results. Unobserved firm heterogeneity could explain the matching between firms and financial expert CEOs as well as firm financial policies. I analyze the matching process itself, and I show some evidence of endogenous CEO-firm matching based on the financial expertise of the CEO and the life cycle of the firm. Several additional tests provide evidence that is mostly consistent with a “financial skills view” interpretation of the effects of financial expertise. As I cannot formally reject the alternative view, it might be a subject for future research.

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Abstract

Does CEO' s financial expertise affect firm' s financial policies and firm value? -Evidence from Korea

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I investigate the effect of CEO' s financial expertise on firm' s financial policies and firm value. Financial expert CEOs tend to hold more cash, more debt, and to engage in less dividend payout. In Korea, financial expert CEOs are found to hold more cash to increase the firm value. Financial expert CEOs themselves have positive effect on the firm value as well. The concern of endogenous CEO-firm matching is alleviated by the analysis based on financial experience: Financial expert CEOs tend to be hired by more mature firms. This result supports the "financial skills view" that a financial expert CEO is needed to actively manage a company which is in the mature life cycle to focus more on the financial side of the balance sheet. This result is consistent with the environment of the Korean labor market for executives where over 70% of the financial expert CEOs are employed by the firms listed in KOSPI200. Furthermore, financial expert CEOs are found to react differently to shocks to overall credit conditions, which again supports the "financial skills view". However, this paper

relies on the assumption that CEO-firm matching cannot be optimal at all times and the findings are partly explained by endogenous CEO-firm matching.