

CEO Reputation and Dividend Payouts

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Abstract. This paper investigates the relationship between CEO reputation and firm's dividend payouts. The results show that reputable CEOs tend to make more investment and pay lower dividends. These results support the overconfident hypothesis that reputable CEOs tend to be overconfident and use the funds to make more investment rather than paying out dividends. These results are important because they show that a manager-specific attribute, i.e. reputation, has a significant impact on a crucial corporate outcome – the extent of corporate dividend payouts.

Keywords: CEO reputation, Dividend payouts, CEO overconfidence.

1. Introduction

The objective of this study is to test whether there is an association between CEO reputation and dividend payouts. Past literature has found a large number of firm-specific variables as the determinants of dividend payouts, such as firm size, market-to-book ratio, leverage, R&D spending, capital expenditures, CEO tenure, and year and industry dummies. Besides the explanatory variables mentioned above, this paper adds one more explanatory variable—that is, CEO reputation. The reason that this study includes CEO reputation is motivated by three considerations. First, CEO reputation is one of the most important intangible assets that a firm has (Gaines-Ross, 2003); second, it captures the dimension of managerial human capital (Francis, Huang, Rajgopal and Zang, 2008); and last, according to Burson-Marsteller's survey in 1999, almost half of a firm's reputation is based upon the image of its CEO. Thus, this CEO characteristic can potentially have an impact on corporate policies. The evidences of this paper reveal that CEO reputation affect the firm's dividend payouts; and CEOs that enjoy a strong reputation develop overconfidence and these overconfident CEOs tend to pay out lower dividends and to retain more funds for future investment opportunities because they are confident that they will be able to get a higher rate of return from future investments and that the investments they make will contribute to higher growth for the firm compared to the scenario in which the firm pays out dividends.

2. Background Theory

Few works in the finance and economics literature have considered the effects of managerial characteristics on firm investment and financing decisions. Bertrand and Schoar (2003) found that managerial style affects a firm's corporate policy decisions and these differences were also seen in the compensation levels of managers. Richardson, Tuna, and Wysocki (2003) found that firms that share common directors also share the following: governance, financial, disclosure, and strategic policy choices. Chevalier and Ellison (1999)'s investigation on the effect of the age and schooling of the mutual fund manager on the performance of funds found that younger managers and managers that had attended good schools earned higher rates of return. Graham and Harvey (2001) have provided evidence that CFOs with an MBA degree use more sophisticated valuation techniques compared to those that do not have an MBA.

In Milbourn's (2003) study, he focused on the CEO's reputation and measured it in terms of the number of press articles that cited the CEO. He found that compensation contracts given to CEOs with a good reputation (i.e., those with more media-counts) exhibited greater pay-for-performance sensitivity. Liu,

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Zhang, and Jiraporn (2011), on the other hand, investigated the relationship between the CEO’s reputation and corporate risk-taking; and their empirical results indicated that reputable CEOs tend to take more risks, “especially idiosyncratic and unlevered risk[s]” (Liu, Zhang, and Jiraporn, 2011). Investigations on the channels of risk-taking activities have revealed that CEOs with strong reputations tend to seek R&D investments but avoid higher financing risks. Finally, a study on the impact of the CEO’s reputation on credit ratings found that firms in which the CEO enjoyed a strong reputation experienced lower credit ratings.

These results suggest that a manager-specific attribute such as reputation can have a significant impact on important corporate outcomes and can influence corporate risk-taking. These results are still robust even after controlling for a large number of firm-specific variables, such as firm size, market-to-book ratio, leverage, R&D spending, capital expenditures, CEO tenure, and year and industry dummies. In terms of economic significance, a one-standard-deviation shock in CEO’s reputation increases firm risk by as much as 16.16%; thus the impact of a CEO’s reputation can be considered statistically significant as well as economically meaningful. In fact, a good reputation can have a negative outcome; according to March and Shapira (1987), Sitkin and Pablo (1992), Kahneman and Lovallo (1993), and Liu, Zhang, and Jiraporn (2011), a strong reputation may create overconfidence, resulting in the CEO’s overestimation of his or her problem-solving capability and, as a result, the CEO might exhibit more aggressive risk-taking behavior.

3. Research Method

Three hypotheses that could explain the association between CEO reputation and dividend payouts are:

(1) The Irrelevance Hypothesis which assumes that managers are homogeneous and selfless inputs into the production process. It also suggests that different managers can be regarded as perfect substitutes for one another. This hypothesis predicts that CEO reputation has no association with the dividend payouts of firms.

(2) The Overconfidence Hypothesis which argues that a CEO that enjoys a strong reputation is vulnerable to overconfidence and tends to take more risks. Therefore, CEO reputation is positively related to risk. If reputable CEOs tend to take greater risks, then greater investment in risky projects should be observed in firms with reputable CEOs. As a result, this hypothesis predicts a negative relationship between reputable CEOs and dividend payouts.

(3) The Reputation Hypothesis which argues that reputable CEOs exhibit a higher degree of risk aversion because of career concerns and possible damage to their image. Reputable CEOs have more to lose than less reputable ones and are expected to be more risk-averse. Warren Buffett once said, “it takes twenty years to build a reputation and five minutes to destroy it.” Based on these arguments, this hypothesis predicts that reputable CEOs, given that they have more to lose if their firms perform poorly, tend to need fewer funds for making investments and therefore payout more dividends.

This paper tests the hypotheses by running multivariate tobit regression and logistic regression of CEO reputation on firm’s dividend, controlling for other factors, as specified in equation (1), (2), and (3). Table 1 shows the definition of each variable in the equations. For equation (1) and (2), tobit regression is employed for regressing dividends/sales and dividends/total assets ratios because these dependent variables have a limitation in the sense that they cannot be negative. For equation (3), logistic regression is employed for regressing dividends payout dummy variable that takes a value of one if firm pays dividend and zero otherwise.

$$dv_ta = f(\text{totalcite}, \text{size}, \text{mtb}, \text{bklev}, \text{rda}, \text{capex}, \text{tenure}, \text{Isic2d}, \text{yr}) \quad (1)$$

$$dv_sale = f(\text{totalcite}, \text{size}, \text{mtb}, \text{bklev}, \text{rda}, \text{capex}, \text{tenure}, \text{Isic2d}, \text{yr}) \quad (2)$$

$$dv_pay = f(\text{totalcite}, \text{size}, \text{mtb}, \text{bklev}, \text{rda}, \text{capex}, \text{tenure}, \text{Isic2d}, \text{yr}) \quad (3)$$

Table 1: Definition of Each Variable in Equation 1, 2, and 3.

<i>Variable Name</i>	<i>Definition</i>
<i>Totalcite</i>	<i>Total number of citations (CEO reputation)</i>
<i>Size</i>	<i>firm size (total assets)</i>
<i>Mtb</i>	<i>market-to-book ratio</i>

<i>Bklev</i>	<i>book leverage ratio</i>
<i>Rda</i>	<i>R&D expenditures by total assets</i>
<i>Capex</i>	<i>Capital expenditures by total assets</i>
<i>Tenure</i>	<i>The number of years the CEO has been in power</i>
<i>dv_ta</i>	<i>dividends/total assets</i>
<i>dv_sale</i>	<i>dividends/sales</i>
<i>dv_pay</i>	<i>dividends payout ratio</i>
<i>Isic2d</i>	<i>Industry dummies based on the 2-digit SIC code</i>
<i>Yr</i>	<i>Year dummies</i>

4. Data & Results

This study uses S&P 500 companies over the period 1992-2007, as identified from the ExecuComp database. CEO reputation is measured based on how parties external to the firm view the CEO, as reflected in the number of articles containing the CEO's full name and company affiliation that appeared in major U.S. and global business newspapers and newswires in calendar year *t*. In particular, following Milbourn (2003), Francis et al. (2008), and Liu, Zhang, and Jiraporn (2011), the search for press releases was conducted in the following major U.S. and international newspapers: the *Wall Street Journal*, the *New York Times*, the *Washington Post*, *USA Today*, the *Financial Times*, the *Asian Wall Street Journal*, *Wall Street Journal Europe*, and the *International Herald Tribune*. An article is included once if it contains the CEO's full name and company name. The number of article counts in a year was used as a proxy for the CEO's reputation in that year (Milbourn, 2003; Rajgopal et al., 2006; Liu, Zhang, and Jiraporn, 2011).

The financial data were obtained from Compustat and stock returns from CRSP. This study excluded financial and utility firms from the sample. The final sample had 4,036 CEO-year observations corresponding to 316 unique firms.

Table 2 shows the descriptive statistics of total citation, dividend variables, and other control variables as specified in equation (1) and (2). The definition of each variable is described in Table 1 in the above section.

Table 2: Descriptive Statistics of Firm Characteristics

<i>Variable</i>	<i>Mean</i>	<i>1st Quartile</i>	<i>Median</i>	<i>3rd Quartile</i>	<i>Std. Dev.</i>	<i>N</i>
<i>Dependent Variable</i>						
<i>Total Citation</i>	38.09	2.000	10.000	35.500	83.903	4,036
<i>Dividend Variables</i>						
<i>Dividend/Total Assets (10⁻³)</i>	15.544	0.464	10.279	20.781	24.840	4,036
<i>Dividend/Sales (10⁻³)</i>	17.550	0.448	10.764	22.686	35.709	4,036
<i>Policy Variables</i>						
<i>Bklev</i>	0.221	0.115	0.213	0.313	0.148	4,036
<i>Mklev</i>	0.125	0.043	0.101	0.180	0.106	4,036
<i>Rda</i>	0.033	0.000	0.009	0.050	0.047	4,036
<i>CAPEX</i>	0.060	0.039	0.048	0.078	0.045	4,036
<i>CEO/Firm Char.</i>						
<i>Total Assets</i>	16049.6	2700.5	6086.5	16228.3	41995.7	4,036
<i>Tenure</i>	7.380	2.573	5.088	9.670	6.917	4,036
<i>MTB</i>	2.581	1.486	2.025	3.004	1.714	4,036

Table 3 shows the results of tobit regression and logistic regression that regress the dividend variables on the CEO reputation and other controlling factors. Based on the results, CEO reputation is significantly negatively related to firm's dividend for all models even after controlling for other factors (at 5% significant

level). These results support the overconfidence hypothesis which predicts that reputable CEOs tend to be overconfident and therefore use funds to make more investments rather than to payout dividends.

For the controlling variables, the results show that firm size has significant positive association with dividend payout (at 5% significant level). However, firm R&D expenditures by total assets have significant negative association with dividend payout (at 5% significant level). The results are mixed for other variables.

The significant negative association between firm R&D and dividend payout shows that firms that invest more in R&D have a tendency not to payout dividend. It also support the overconfidence hypothesis that reputable CEOs are less likely to pay dividend because they make more R&D expenditures which implies that the reputable CEOs tend to be more confident that their investments will turn out to be successful.

Table 3: Tobit and Logistic Regression of the Dividend Variable on the CEO Reputation and Other Controlling Factors

<i>Tobit regression of div_ta</i>				
<i>Variable</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>t</i>	<i>P> t </i>
<i>totalcite</i>	-2.2E-05	5.14E-06	-4.25	0
<i>Size</i>	0.003480	0.000353	9.86	0
<i>Mtb</i>	0.003451	0.000268	12.88	0
<i>Bklev</i>	-0.00175	0.003091	-0.57	0.57
<i>Rda</i>	-0.12587	0.011952	-10.53	0
<i>Capex</i>	-0.01523	0.010883	-1.4	0.16
<i>Tenure</i>	-0.00022	0.000055	-3.98	0
<i>Tobit regression of div_sale</i>				
<i>totalcite</i>	-2.5E-05	6.16E-06	-4.04	0
<i>Size</i>	0.005365	0.000426	12.59	0
<i>Mtb</i>	0.002899	0.000324	8.94	0
<i>bklev</i>	0.003909	0.003728	1.05	0.29
<i>rda</i>	-0.11271	0.014325	-7.87	0
<i>Capex</i>	-0.04044	0.013098	-3.09	0
<i>Tenure</i>	-0.00028	0.000066	-4.25	0
<i>Logistic regression of div_pay</i>				
<i>totalcite</i>	-0.00615	0.001184	-5.19	0
<i>Size</i>	0.820645	0.1025085	8.01	0
<i>Mtb</i>	0.000492	0.0547482	0.01	0.993
<i>Bklev</i>	0.634854	0.6668254	0.95	0.341
<i>Rda</i>	-16.4878	2.711208	-6.08	0
<i>Capex</i>	5.466696	2.191188	2.49	0.013
<i>Tenure</i>	-0.00506	0.0124631	-0.41	0.685

5. Conclusion

This research explores the relationship between CEO reputation and firm dividend payouts. The existing hypotheses suggest that reputable CEO may pay more or less dividend, or may be irrelevant to dividend payout. Reputable CEO may pay more dividends because they are afraid to make risky investment that could ruin their reputation if the investment turns to be a failure. However, the counter argument states that reputable CEO may pay lower dividends because they are overconfident that their investments will be successful and so they would like to make more investment. Using press coverage (media counts) to proxy for CEO reputation, this study conducts empirical tests and finds that firms with reputable CEOs tend to make more investment in R&D and tend to pay lower dividends. The logistic regression shows that firms with more reputable CEOs are less likely to payout dividends. The results remain robust and significant at 5% level for both tobit regression and logistic regression, and also after controlling for other firm's policy variables, CEO variables, and firm's characteristic variables. Our results have important implications

because they show that a manager-specific characteristic has a significant influence on corporate dividend payouts.

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