

The Role of CEO Experience and CEO Multiple Directorships in Palestinian Firm Performance: The Moderating Effect of Political Connection

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ABSTRACT

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There is little doubt that political environment issues have tremendously affected application of corporate governance. Palestine experienced instability in the political situation due to Israeli occupation and for the pluralism of its party structure (Fatah is the ruling party and Hamas the opposition party). Hence, political connection serves as unique kind of external resources which can enhance the firm's performance, through political mechanisms, companies attempt to create for itself an environment that is better for its interest. The CEO characteristics play major role in the Palestinian firms and have been seen among the most important factors to enhance the firm's performance. Many companies excelled as a result of their CEOs attributes. However, previous studies document mix and inconclusive results on CEO characteristics and firm performance. This paper provides conceptual arguments that allow for better understanding of the role of political connection on the relationship between CEO experience and firm performance. For companies, this study proposes that they should put more efforts on enhancing the role and the quality of the CEOs. Besides providing suggestions for future research, this study provides several recommendations to the Palestinian Capital Market Authority and PSE to improve its rule and regulation with respect to CG mechanisms.

Keywords:

CEO experience, CEO multiple directorships, political connection, firm performance

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1. Introduction

Firm performance has become a standard metric for profit-making entities to measure the achievement of the objectives of strategic management, and the ability of a firm to create value [1]. Usually, the achievement of a company is measured by its firm performance [1]. Albatayneh [2] defines performance as the ability of a firm to reach its goals by utilizing resources productively. Although, firm performance can be categorized into financial and non-financial performance, most of accounting literature focussed on financial performance [3]. Several studies document the underperformance of Palestinian listed firms more especially after the Al-Aqsa Intifada on

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September 2000 [4, 5]. Abdelkarim [4] argues that the performance of most of the Palestinian listed companies is quite below expectation, hence requires considerable investigation. This position conforms to the report of the Palestinian stock exchange that the operational revenue of the listed companies has been declining considerably since 2011, a clear indication of underperformance.

Several studies document numerous factors that influence the firm performance including Chief Executive Officer's attributes. Chief Executive Officer (CEO) is considered as one of the main factors that enhance the ability of firms to reach their economic goals and enhance the firm performance [6]. Peterson *et al.*, [6] define CEO as someone who serves as the most senior corporate officer, executive, or administration, monitors the organization and holds responsibility for the operations in the firm completely. The CEO of an organization usually interacts with the board of directors and is tasked with maximizing the profits of a company [7, 8]. In view of this, many corporate governance codes requires the CEO to possess certain qualities and attributes to enable them to discharge their duties diligently. In Palestine, the Palestinian Code of Corporate Governance requires the Palestinian listed companies to select the CEO with high experience and qualifications. Despite the importance of the CEO experience in determining the level of firm's performance, the issue received less attention of the researchers globally and the outcome of those studies are inconclusive.

Some studies attribute expert CEO with the dedication and good monitoring which leads to improved efficiencies across the organizational functions [9]. Expert CEO utilizes the use of accounting conservatives which lead to accurate earnings forecast [10]. CEO expertise minimizes the tendencies of frauds and irregularities in organizations [11]. Contrarily, some studies document a negative relationship between CEO experience and firm performance [12]. CEOs with more expertise consume in terms of compensation more than their incremental profitability. Hence reduces the financial performance of the companies [13]. It is even argued that prior experience of the newly appointed CEOs may not be compatible with the operation of the firm [14].

Similarly to above, CEO multiple directorship plays pivotal roles in determining the performance. The CEO multiple directorships as the CEO sit on more than one board in other companies [15]. It can be argue that CEOs acquire more expertise and technical know-how once they sit on the board of many corporate bodies. CEO multiple directorship enables the CEOs to improve the performance of their managed companies from mingling with board other members through multiple directorship. However, this may not stand considering the busyness hypotheses. Ferris *et al.*, [16] argue that a busy CEO may find it difficult to conduct his responsibilities effectively. Therefore, this study provides a conceptual review on the importance of CEO attributes in enhancing the firm performance.

Palestinian political life stands out in the Arab world for the pluralism of its party structure. The largest parties are Fatah and Hamas. Some studies find that the political division leads to economic instability and environment turbulence, which negatively affected the performance of companies [5]. However, several studies document that companies with political contact with the ruling party benefit from such relationship through tax reliefs, power and influence, government subsidies and easy to get bank financing which in turn improve the company's performance [17]. Therefore, in-depth study needs to examine whether these factors moderate the relationship between CEO characteristics and firm performance. Besides, this study focuses on the CEO experience and CEO multiple directorships among the CEO characteristics that based on the requirement of the PCCG.

Accordingly, this study proposes the political connections as a moderating variable that could strengthen the relationship between CEO experience and firm performance in the context of Palestine. This in line with the recommendations for testing moderating effects by Baron and Kenny [18], that when a relationship between an independent and a dependent variable are found to be

low. According to Wu and Zumbo [19] one of the reasons that a true causal effect is not found or unexpectedly weak may be that there is a hidden moderation effect. This study differs from the previous studies in so many aspects. The first aspect, the studies in Palestine with respect to the CEO characteristics have focused only on the CEO duality [20, 21] neglecting other aspects of CEO attribute. The second aspect is that, the current study introduced the moderating effect of political connection on the relationship between CEO experience and firm performance. This aspect has contributed in understanding the effect of political connection on the relationship between CEO attributes and firm performance.

This paper is organized in four sections, section one is the introduction, section two is the literature review related to the variables, section three is the conceptual framework, section four is the discussion of the study, lastly section five presents the conclusion of the stud.

2. Literature Review

2.1 Firm Performance

Firm performance is one of the major indices used to attract the attention of investors to the firm. It is also been used to evaluate of the effectiveness of the policies and activities of the management that are entrusted with the shareholders' fund under their custody. Fauzi *et al.*, [22] defined firm performance as the ability of a firm to deploy its resources effectively to achieve its goal. Firm performance can divided into financial and non-financial performance. Financial performance measures in monetary terms, the results of the policies and activities put in place to attain organizational objectives [3]. The indices used in measuring the financial performance include but not limited to Return on Assets, Return on Equity, Sales, Cash flow, gross margin, net margin, total cost, among others.

Stakeholders in the financial reporting circle use the information on the firm performance make numerous economic decisions. These stakeholders include the shareholders, management, potential investors, creditors, employees, tax authority and the general public. Each of these categories of stakeholders uses the information on the firm performance to make wise economic decisions. Although there is convergent views of what constitute performance and how can it be measured [23], recent studies are more align to financial measures rather than market based and non-financial measures [24].

2.2 Chief Executive Officer Experience

The expert CEO refers to the person who serves as a chief financial officer, chief accounting officer or vice-CEO responsible for the finance or accounting department [25]. Wegge *et al.*, [26] find that the CEO with more experience strengthens the performance of a firm for being able to manage the business environment. Concerning corporate R&D decisions, it is important for CEOs to have a career experience in various occupations as they could integrate new technology into the firm on the basis of their prior career experience [27].

Moreover, Jiang *et al.*, [25], Matsunaga and Yeung [10], and Schrand and Zechman [11] document that a well experienced CEO provides more conservative accounting practices and more precise earnings forecasts for companies managed by them. In addition, if CEO has an accounting expertise, the frauds are less likely to occur in the companies. In short, CEO with career experience improves the effectiveness and efficiency of their organizations. This is in line with resource dependant theory suggesting that experience has a positive impact on firm performance [28].

Erickson *et al.*, [12] opined that CEOs having experience require more rewards and incentives. This results in higher costs which contribute to reducing corporate performance. As for Hamori and Koyuncu [29], the CEO with prior experience is negatively related to post-succession financial performance of firm. In other words, transferring job-specific skills across organizations always involves a performance penalty.

2.3 CEO Multiple Directorships

CEO multiple directorship is a situation where by the CEO sit on the board of other companies [15]. PCCG 2009 requires the CEO of a listed firm to be a full-time employee of the firm. This is to enable the CEO to concentrate and dedicate more time on managing the affairs of the firm. However, many CEOs engage in the management of many companies other than the one that are employed for. Ferris *et al.*, [16] revealed that some CEOs of some listed companies sit on the board on more than sever companies. These activities have dual effect on the company's performance. Based on the busyness hypotheses, a CEO with multiple directorships may find it difficult to manage the affairs of his firm effectively. The Council of Institutional Investors [30] that established goals and guidelines for the effective governance of publicly traded corporations stated that CEOs should not serve as a director of more than one other company at the same time. This is because; a CEO with many directorships may lack the time to give his best to so many corporate boards [31]. On the contrary, Jiraporn and Liu [32] believe that CEOs with multiple directorships will gather more experience for better monitoring and advising roles. Similarly Chiang and He [33] argue that managers who hold dual jobs will have better business knowledge and experience.

2.4 Political Connection

Faccio *et al.*, [34] define the political connection of a company as a strong relationship between the company's main shareholders, board members or executive officers with the government officials. In Palestine, one of the results of political division has been fundamental changes in markets and their structures and damaging the performance of companies in particular and the general economic structure of the country in general [35]. To overcome these issues, companies tend to build political connections with the governing party to get government-related benefits. Political connections help firms to attain key resources, including bank loans, favourable tax treatments and market power [36]. Thus, firms with political affiliation stand a chance of benefiting directly from the government or indirectly by seeking favour from their political cronies [37].

Menozzi *et al.*, [38] consider firm as politically connected if its directors are previously or presently hold a seat in the parliament, local government. On general note, firms are seen as politically connected when the directors' affiliation with political parties is well known. On the same note, Wu *et al.*, [39] define a firm as politically connected if the CEO of the firm is currently serving or has formerly served in the government or the military. Moreover, where a firm's director has worked with government ministries/establishment or has supported the governmental party through donations and alike such firm can be regarded as political connected [40]. In case of Palestine, a firm is considered as politically connected if the CEOs or the directors have previously or currently work in government position. This is based on the work of Barakah [41] which documents that government employee is a Fatah member.

Many studies find that political connection affect the firm performance positively. For example, in a study of privately listed firms in China, Yang *et al.*, [17] find that politically connected private enterprises could acquire more loans from banks. The authors also document that building political

connections was a substitute mechanism for private enterprises to overcome the drawbacks of market institutions. Similarly, Claessens *et al.*, [42] stated that managers that are connected with the government party exploit this relationship to get support and government resources (e.g. tax benefit), therefore this relationship has a positive impact on firm performance. Political connections have also been found to impact government subsidies and firm performance. For example, Zhang *et al.*, [43] investigate the relationship among political connections, government subsidies and firm financial performance on solar energy manufacturing in China. The results reveal that political connections give a company a chance to receive more government subsidies that led to the improved financial performance of renewable energy manufacturing companies.

2.5 Underpinning Theory

Resource dependency theory provides the underpinning support on how CEO experience and the political connection affect the performance for the firms. Pfeffer and Salancik [44] posited that organizations are dependent upon their external environments in an attempt to reach the goals. These environments provide firms with experienced people either local or international, knowledge, powerful, diversity of people and certified educations for achieving the firm's goals. Mixing the firms internal resources with those acquired from interacting with external environment lead to maximize profits and increase shareholder wealth [7]. One of the important external environments that can be exploited is the political connection. Pfeffer and Salancik [44] noted, "the organization, through political mechanisms, attempts to create for itself an environment that is better for its interest" (p. 189) and that "organizations may use political means to alter the condition of the external economic environment" (p. 190). Therefore, the political connection is one of the mechanisms that could help the companies to maximize profits.

Moreover, CEOs multiple directorships could serve as external source of resources to the firm. However, the busyness hypothesis posited that it difficult to manage the affairs of his firm effectively when the managers engage in the management of many companies [16]. Therefore, any additional outside board memberships by CEO only decrease companies effectiveness.

3. Conceptual Framework

In Figure 1 the research framework of this study has been demonstrated. According to the Figure, the independent variables are the CEO experience and CEO multiple directorships, while firm performance serve as dependent variable. Political connection is proposed as moderating variable.

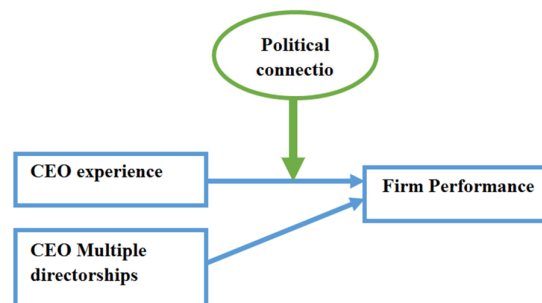


Fig. 1. Conceptual Framework

Previous studies on the relationship between CEO experience and firm performance produced inconclusive results. Many studies found that greater experience of the CEO could enhance the firm

performance, and other studies found that the CEO's experience adversely affected performance. This inconsistent results signal the existence of black-box in the relationship which need to be resolved. In view of this, this study proposes the use of political connection to resolve the inconsistencies. The political connection could be able to strengthen the relationship between CEO experience and firm performance by using the political means to alter the condition of the external economic environment of the company.

4. Discussion

This study suggests the relationship between CEO attributes and firm performance, and the role of political connection on the relationship between CEO experience and firm performance. By reviewing previous literature, the results indicate that the relationships between CEO experience and firm performance have mixed results. The first group was in line with the resource dependence theory which depends on external resources to enhance the company's performance; one of these resources is the management experience. In addition, many studies revealed that the CEO's attributes enable the firm performance to be improved in terms of the ability of an experienced CEO to better manage the business environment. Moreover, the CEO that has a greater experience seems to have a greater ability to improve the efficiency of the company, less fraud, and less accounting errors.

Therefore, due to the inconclusive result in the relationship between CEO experience and firm performance, this study employs the political connection as a moderator to strengthen the relationship. This study proposes the political connection as moderator because the inconsistencies may emanates from the political connection. In line resource dependency theory, some companies resort to the political relations to get new resources for the company to enhance the performance. These resources/benefits include government support, ease of get to loans, market power, avoid government barriers, and get the tax benefits. That is to say, when there is political connection, well experience CEO leverages on that relationship to derive political benefits to the firm which in turn improves the firm performance. On the other hand, when a well experienced CEO has no political connection, it will be difficult for him to derive those benefits based on merit because of the cronyism and turbulence nature of the Palestinian business. Hence, the relationship may turn out to be negative.

Therefore, depending on the resource dependence theory, the existence of experience and multiple directorships have direct positive relationship with firm performance, which leads to maximize profits and increase shareholder wealth. As results, if a CEO has more experience, and sit on the board of many corporations, accounting inconsistency is less likely to occur because he has more experience and knowledge to solve problems. Accordingly, if the CEO possessed a higher experience in addition to the political connections with the ruling parties which is useful for the companies through government subsidies and tax benefits will leads to expectation that the CEO political connections lead to further enhance the firm performance, thus positively moderate the relationship between CEO attributes and firm performance.

On the other hand, in line with the busyness hypothesis, the busy CEO will negatively affect performance and do not give benefits to the company, as the busy CEO owing to the fact that their busyness hinders their capacity to become efficient managers within the firm which may hurt the firm's performance. Moreover, the CEO has the most important role in the companies, therefore when he is busy to manage the company and to miss the meetings which could expose the company to make bad decisions.

Thus, this study will add to the academic knowledge relating to CEO attributes and their effects on a firm's performance in the emerging, yet volatile, market like Palestine. This study contributes

to fills the gap in the literature regarding to the mixed results related to CEO experience and CEO multiple directorships with firm performance by employing the political connection as a moderator variable. This could be use to better understand the relationships among the variables under review. This study fills the literature gaps by focusing on the CEO experience and CEO multiple directorships more especially in emerging, yet volatile economies such as Palestine where literature of the kind is lacking.

5. Conclusion

This study discussed the role of political connection on the relationship between CEO experience and firm performance based on resource dependence theory. Resource dependence theory provides that companies rely on external resources to enhance their performance. Consequently, the political connection of the experienced CEO is one of the external resources of companies. Therefore, based on this theory, the study predicts that the political connection can positively moderate the relationship between CEO experience and firm performance. Similarly, CEOs multiple directorships could serve as external source of resources to the firm, however, the CEO with many directorships may lack the time to give his best to so many corporate boards. This shows that the results about the CEO multiple directorships are still inconclusive, and need further studies in future research.

This paper recommends for empirical studies on the effect of political connection on the relationship between CEO attributes and firm performance. It also recommends the other CEO characteristics should be considered in the subsequent studies such as CEO ownership, CEO family, CEO tenure and CEO qualification, and investigate whether the political connections are able to strengthen the relationship between these variables to enhance the firm performance due to the inconsistent results.

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