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Articles

Powerful CEOs and capital structure decisions: evidence from the CEO pay slice (CPS)

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Abstract

Motivated by agency theory, we explore how powerful CEOs view leverage. Because of the agency conflict, CEOs may adopt sub-optimal leverage levels that promote their own private benefits at the expense of shareholders. Using Bebchuk et al. (2011) CEO pay slice (CPS) to gauge CEO power, we find that powerful CEOs view leverage negatively and avoid high debt. However, CEOs appear to adopt sub-optimal leverage only when their power is sufficiently consolidated. Relatively weak CEOs do not seem to avoid leverage. The effect of CEO power on capital structure decisions is thus nonmonotonic. Our results imply that agency problems lead to self-serving behaviour only when managers command sufficient influence in the company. Finally, we also show that our conclusion is unlikely confounded by endogeneity.

Keywords:

capital structure | leverage | agency problems | CEO power | agency conflict | debt | powerful CEOs

JEL Classification:

G32 | G34

Notes

[1] Several recent studies also use CPS as a proxy for CEO power. For instance, CPS has been shown to have a significant impact on credit ratings and bond yields (Liu and Jiraporn, 2010) and on corporate social responsibility (CSR, Jiraporn and Chintrakarn, 2013).

[2] Free cash flows are calculated as net income plus depreciation and amortization minus capital expenditures.

[3] We also run another regression based on the variation across firms only. The results are not significant. Thus, the effect of CEO power on leverage is driven by the variation within firms over time, rather than the variation across firms. These results are remarkably consistent with those in Jiraporn et al. (2012).

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