

Implication of Myopic Behavior on Firm Financial Performance: Evidence from PSX Listed Companies

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Abstract

Due to the emergence of corporate culture and the listing of firms on stock markets, the managers face enormous pressures to deliver better short-term results. The stock market forces and the quarterly financial result requirements are inducing myopic managerial decisions. Myopic behavior existed in Pakistan, but no direct study was conducted to examine its implications on financial performance. This study aims to provide evidence and also an implication of the myopic behavior of managers on the financial performance of PSX listed companies. This study reviewed the literature and revealed the most pertinent determinants of managerial myopia. We took panel data of 251 firms listed on the Pakistan Stock Exchange (PSX) for the year 2009 till 2018 and used panel data regression analysis to examine the impact of the myopic determinants on the performance of organizations in the context of Pakistan. The results indicate and conclude that managerial myopia exists in Pakistan, which affects the profitability and efficiency of firms. This study contributed to existed literature related to managerial myopia in the context of Pakistan.

Keywords: myopic behavior, financial performance, CEO expertise, TMT size, inside/Outside CEO, discretionary expenses

Introduction

In the development of plans, value, and competitiveness of businesses, managers play a leading role. In this context, however, there are many challenges to these decisions. Many managers do everything possible to produce outstanding results (Ji, 2020). Myopic management refers to top management's decisions to maximize shareholder capital at the cost of the company's long-term profitability (Porter, 1992). Business managers face enormous short-term financial pressure to deliver good financial results (Abbasi & Tamoradi, 2020). The theories of Agency (Jensen, 1986), bounded rationality (Simon, 1957), and upper echelon

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(Hambrick & Mason, 1984) all contribute to the phenomenon of managerial myopia.

A study by (Chen, Zhang & Zhou, 2018), found that many managers engage in short-sighted activity by reducing discretionary expenditures when competing to meet financial targets. Decisions to improve the firm's financial performance have a significant impact on revenue, and this shows managers take different steps to avoid an increase in discretionary spending (Meyer & Ujah, 2017).

The stock market's pressure causes finance executives to make myopic decisions, such as cutting investments to produce a positive performance in the short term. (Aghion & Stein, 2008). Firms that are focused on the short term can adjust their TMT Size suddenly or rapidly (Brauer, 2013). Changes in top management are the source of TMT-induced myopia (Pham, Yu & Agha, 2018).

The appointment of the firm's CEO is another significant part of managerial myopia. Laux (2012) claims that firms with outside CEOs have legible short-term improvements in operations and financial performance.

The top managers of organizations in Pakistan also face the pressure of giving good results in the short term (Anjum, Saif, Malik & Hassan, 2012). This research aims to study the objectives of defining the myopic behavior through extant literature and also elaborating pertinent financial performance variables. This study further examines the existence and implication of managerial myopic behavior in the context of firms listed Pakistan Stock Exchange. This study fills the gap by analyzing the key myopic variables, which are constraining the decisions of top managers of Pakistani firms.

Literature Review

Managerial Myopia

Myopia is short-termism, as it focuses on the achievement of current earnings targets while neglecting the long-term earnings (Stein, 1988). Managing myopia focuses on present earnings but does not consider the long-term consequences (Bange & De Bondt, 2003).

The Agency Theory which is related to a manager's decision making states that the allocation of resources is key to the manager-shareholder conflict (Jensen, 196). DesJardine and Shi (2020), argue that the best way to reduce short-termism related to agency dilemma is to encourage long-term investors. Bounded Rationality theory relates that when managers are under a lot of pressure to make decisions, they find it difficult to expand their awareness of existing ideas (Riedl, 2020). Upper echelon theory which focuses on agency theory expresses the importance

of the composition of the top management team in organizational decision making (Bassyouny, 2020).

Tabassum, Kaleem, and Nazir (2015), in their article after studying the sample of companies incorporated in Pakistan, found that managers will manipulate earnings to give good results in short term, inspite of its adverse long-term effects.

Managerial myopia as behavior became prominent with the emergence of modern corporations. The existing literature document important determinants of managerial myopia affecting the firm performance including discretionary expenses (Dechow & Sloan (1991), CEO expertise (Koo, 2019), TMT size (Brauer, 2013), and Inside or Outside CEO (Helmich, 1974; Laux, 2012).

Organizational Financial Performance

There is no definitive answer in the previous studies on the most efficient measure of financial performance. Nonetheless, some of the research including Batchimeg (2017) states that Return on Assets (ROA) is a reliable indicator of a firm's financial health. Another important accounting-based firm financial performance measure is the return on equity, which is the ratio of equity to the income of the firm (Ahmed, Rehan, Chhapra & Supro, 2018). An even better proxy is Tobin's Q, a market-based measure of market value relative to the value of the total assets of the firm. (Abdullah, Shah, Gohar & Iqbal, 2011).

Discretionary Expenses

According to Dechow and Sloan (1991), short-sighted managers cut discretionary spending (e.g. selling general & administrative, advertising, and research & Development Expenses) to accomplish current year revenue targets. Managers may reduce R&D and advertisement expenditure or other SG&A costs to increase recorded revenues, even to the degree that it will impact long-term profitability (Stein, 1988; Roychowdhury, 2006). Therefore, we hypothesize the effect of myopic behavior of curbing discretionary expenses by managers on the firm financial performance as follows:-

H₁ = Myopic behavior is linked to cutting discretionary expenses and it significantly affects the financial performance of the company.

CEO Expertise

With the increase of the experience and maturity of the managers, managerial myopia goes on an uptrend (Noe & Rebello, 1997; Koo, 2019). Financial experts have an in-depth understanding of various investment

opportunities (Aghion & Stein, 2008). The short-term financial pressures caused by stock market expectations for good performance will lead the financial experts to make myopic decisions in favor of optimizing the short-term stock prices (Antia, Pantzalis & Park, 2010). Consequently, the hypothesis for the CEO financial expertise implication on financial performance is as follows:-

H₂ = Myopic behavior is linked to CEO Expertise and it significantly affects the financial performance of the company.

Variability of TMT Size

According to Porter, Lorsch, and Nohria (2004), CEOs and executive team members should collaborate and work together to reach organizational objectives. Changing top executives too often hinders long-term planning, so TMT variability is the essential determinant of managerial myopia. (Pham et al, 2018). The short-term-oriented business would try to hire and fire managers more often as benchmarks are not being met (Brauer, 2013). Hence, the hypothesis of TMT size in relation to the financial performance is as under:-

H₃ = Myopic behavior is linked to TMT size variability and it significantly affects the financial performance of the company.

Inside / Outside CEO

According to Laux (2012), companies with external CEOs are more inclined to turnover, are under pressure to generate short-term gains, and therefore are more prone to myopic behavior. On the other hand, an inside hired CEO is already acquainted with the company and faces no possibility of layoffs, making him more attuned to the long term. There seems to be an inverse relationship between financial results and the likelihood of CEO replacement from outside (Cannella & Lubatkin, 1993). Accordingly, the hypothesis of impact of CEO selection on the financial performance is as follows:

H₄ = Myopic behavior is linked to the hiring of CEOs inside/outside and it significantly affects the financial performance of the company.

Research Methodology

Sample and Data Collection Techniques

We collected data of all the firms listed on the Pakistan Stock Exchange for the period 2009 to 2018. We removed firms with missing financial statements data, defaulted firms, and firms having non-

availability of data on some variables. Our final sample used for analysis included 251 firms, both from financial and non-financial sectors. After removing outliers from the data, we got a resulting unbalanced panel of 2310 observations.

We picked the data from annual reports of individual firms in our sample, PSX website, State bank of Pakistan website, and other financial and business websites including khistocks.com, linkdin.com, archive.org, relationshipscience.com, ksestocks.com, and opendoors.pk.

Nature of Study

This research studies the impact of managerial myopic behavior over a passage of ten years on the different cross-sections, so the study is applied in nature and follows descriptive and explanatory research design.

Estimation Methods

Previous research used various methods of regression estimation for analyzing panel data on managerial myopia (Meyer & Ujah, 2017). These include, OLS pooled regression, GMM estimation, Fixed and Random effect, Robust OLS regression (Meyer & Ujah, 2017; DesJardine, 2016). We have used Pooled OLS, Fixed Effects, and Random Effects estimation. Among these three methods, we selected the best method based on Hausman (1978), and Breusch and Pagan (1980) LM Test.

Variables Measurement

Dependent variables

The financial performance of the company is our dependent variable, which is made up of three sub-variables: ROA, ROE, and Tobin's Q.

ROE and ROA are accounting or profitability measures, while Tobin's Q is the market-based measure of the firm financial performance. Both types of variables have been used in many studies simultaneously for the firm financial performance.

Independent variables

Managerial Myopia is the main independent variable that can be measured through different proxies. Our independent variables and the determinants of managerial myopia are CEO Financial Expertise, Inside/Outside CEO, TMT or Top Management Team Size, and Cut Discretionary Expenses.

Control Variables

The control variables we used include; firm size, firm age, growth, and sector dummy. There are two main sectors, financial and non-financial. Therefore, we have created sdummy or Sector Dummy to capture the sector-wise effects concerning the main variables of the study.

Table 1: Summary and Description of Variables

Variable Name	Description	Variable Type	Formula / Calculation	References
Roa	Return on Assets	DV	Net Income/Total Assets	Anderson and Reeb (2003)
Roe	Return on Equity	DV	Net Income/Total Equity	Jahan (2012)
Tq	Tobin's Q	DV	The market value of the company/asset replacement cost	Antia et al. (2010)
Ceoexp	CEO Expertise.	IV	Finance and Relevant Qualification+ Experience. 1 for expert and vice versa	Brochet and Welch (2011)
Msga	Cut discretionary expenses.	IV	Marketing +Selling + General and Administrative expenses.1 if cutting discretionary expenses leads to an increase in income and 0 for vice versa	Chen et al. (2018)
Tmssize	TMT Size Variability	IV	Year on Year Change in TMT	Pham et al. (2018)
Ioceo	Inside/Outside CEO	IV	Dummy. 1 for Inside and 0 for outside CEO	Laux (2012)
Fage	Firm Age	CV	Number of Years since firm establishment	Loderer and Waelchli (2010)
Fsize	Firm Size	CV	Log of Total Assets of Firm	Anderson and Reeb (2003)

Growth	Growth	CV	year-on-year percentage change in fixed assets	Bamiatzi and Kirchmaier (2014)
Sdummy	Sector Dummy	CV	1 for non-financial and 0 for the financial sector	-----

DV= Dependent Variable, IV= Independent Variable, CV= Control Variable

Model Specification

The baseline model is a panel estimation with the following specification:

$$Perf_{it} = \alpha + \beta_1 CEOExp_{it} + \beta_2 Msga_{it} + \beta_3 TMTSize_{it} + \beta_4 IOCEO_{it} + \beta_5 Fage_{it} + \beta_6 FSize_{it} + \beta_7 Growth_{it} + \beta_8 Sdummy_{it} + \theta_i + \varepsilon_{it} \tag{1}$$

Perf_{it} = ROE, ROA, Tobin’s Q of the firm I in time t, i = 1... 251 firms, t = 2009–2018, θ_i is the time-invariant error term and ε_{it} is the time-varying error term.

We used pooled ordinary least squares estimation in Eq. 1. In this method, we are treating each cross-section as a completely independent sample of the population (Wooldridge, 2010). We then move on with the fixed-effects model in Eq. 2 as the appropriate model based on the Hausman test.

$$Perf_{it} = \alpha_i + \beta_1 CEOExp_{it} + \beta_2 Msga_{it} + \beta_3 TMTSize_{it} + \beta_4 IOCEO_{it} + \beta_5 Fage_{it} + \beta_6 FSize_{it} + \beta_7 Growth_{it} + \beta_8 Sdummy_{it} + \varepsilon_{it} \tag{2}$$

In Eq. 2, for each company, we implement a different α_i intercept, which controls unnoticed company characteristics.

Results

Descriptive Statistics

Table II shows Descriptive statistics and Table III presents Pearson correlations between the variables.

Table II: Descriptive Statistics

Variable	Mean	Std.Dev.	Min	Max
Roa	.05	.074	-.25	.39
Roe	.125	.202	-1	.96
Tq	1.223	.596	.17	3.98
Ceoexp	.625	.484	0	1
Msga	.12	.325	0	1
Tmtime	1.465	.82	0	3.599
Ioceo	.751	.433	0	1

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Fage	3.465	.572	.693	5.063	
Fsize	9.022	1.955	3.89	14.87	
Growth	1.956	1.203	-2.699	4.848	
Sdummy	.819	.385	0	1	

Table III: Correlation Matrix

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) Roa	1.00									
(2) Roe	0.59	1.00								
(3) Tq	0.34	0.28	1.00							
(4) Ceoexp	0.01	0.02	0.05	1.00						
(5) Msga	0.02	0.04	0.02	0.01	1.00					
(6) Tmtsize	0.10	0.15	0.14	0.03	-	1.00				
(7) loceo	0.00	0.04	0.02	0.01	0.01	0.2	1.00			
(8) Fage	0.05	0.05	0.15	-	-	0.0	0.04	1.00		
(9) Fsize	0.06	0.15	0.01	0.09	-	0.8	-	-	1.00	
(10) Growth	0.08	0.11	0.00	0.00	-	0.5	-	0.06	0.5	1.00

Table II displays descriptive estimates for all of the study's variables. This table shows the means, standard deviation, maximum, and minimum values of all the variables. The analysis of values of all the variables shows that the data is looking normal as there are no very high

and very low maximum or minimum values, which will create variance from the mean.

Table III is having the coefficient matrix of all the variables. By analyzing the coefficient matrix, we can check the multicollinearity assumption of regression. Like in Table; we see that none of the values of the correlation coefficient is greater than 0.90 which shows that the data is not having the multicollinearity problem.

Regression Analysis

OLS Pooled Regression Analysis

Table IV: Pooled Estimation

	(Pool) ROA	(Pool) ROE	(Pool) TQ
Msga	-0.007*** (0.003)	-0.025** (0.013)	-0.061* (0.037)
Ceoexp	-0.005*** (0.002)	-0.007** (0.009)	0.001 (0.026)
Tmssize	-0.014*** (0.004)	-0.019** (0.010)	0.320*** (0.028)
Ioceo	-0.005 (0.004)	-0.008 (0.011)	-0.047** (0.020)
Fage	0.003 (0.003)	0.016** (0.007)	0.132*** (0.021)
Fsize	-0.001 (0.002)	0.013*** (0.004)	-0.083*** (0.012)
Growth	0.001 (0.002)	0.001 (0.004)	-0.045*** (0.012)
Sdummy	0.035*** (0.005)	0.040*** (0.013)	0.208*** (0.036)
_cons	-0.004 (0.015)	-0.092** (0.042)	1.010*** (0.119)
Obs.	2306	2306	2306
R-squared	0.042	0.037	0.095

Standard errors are in parenthesis

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table IV shows the ordinary least squares (OLS) pooled regression model. We have four columns showing three dependent

variables on the right side, while the independent and control variables are on the left side. The standard errors are shown in the parenthesis, while the coefficients are without parenthesis.

Pooled OLS regression results are significant, but we cannot rely solely on Pooled OLS as it is not the robust method of regression estimation. Pooled OLS regression considers constant intercept and slopes coefficients, and as this is not true for all companies, so Pooled OLS cannot be relied upon (Wooldridge, 2010).

Further Regression Analysis

Pooled OLS is not the best method of regression estimation and therefore, we have used regression estimates of Fixed and Random effects.

Testing for Appropriateness of OLS, FE, and RE Models

We have tested for OLS and Random Effects Models to select that which one is the most appropriate method of estimation.

We chose between the OLS model and random effects model by applying Breusch and Pagan Lagrangian multiplier test. (Breusch & Pagan, 1980). In our analysis of the LM test result, we get $p < 0.05$, suggesting that random effects are the appropriate model to choose between OLS and Random effects.

After deciding between OLS and random effects and getting random effects as an appropriate model, now we have to choose between fixed or random effects models. The test used for this purpose is the Hausman test (Hausman, 1978). The Hausman test in our sample yielded a p-value of less than 0.05, suggesting that the fixed effects model is a good fit for our analysis.

Fixed Effects Estimation Analysis

Table V shows the results of the fixed effects (FE) regression model for our sample. The acceptable model is the fixed effects (FE) if the interest is to examine the influence of time-varying variables. FE represents the relation of the predictor to dependent variables in an entity. Each entity has different characteristics which could either increase or decrease the significance of the predictors. (Borenstein et al., 2010).

The least-square dummy variable estimator (LSDV) is another name for the fixed effects model since we treat each entity as if they were a dummy.

Table V: Fixed Effects Estimation

	(FE)	(FE)	(FE)		
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	ROA	ROE	TQ
Msga	-0.005*** (0.002)	-0.004** (0.002)	-0.022 (0.027)
Ceoexp	-0.001** (0.000)	-0.026*** (0.010)	-0.111*** (0.038)
Tmssize	-0.009** (0.004)	-0.001** (0.000)	0.309*** (0.033)
Ioceo	-0.022*** (0.006)	-0.042** (0.020)	-0.067** (0.034)
Fage	0.054*** (0.011)	0.134*** (0.036)	0.424*** (0.078)
Fsize	-0.012*** (0.004)	0.024** (0.012)	-0.058** (0.028)
Growth	0.002 (0.001)	0.003 (0.005)	0.007 (0.010)
Sdummy	omitted	omitted	omitted
_cons	-0.052 (0.034)	-0.147 (0.114)	-0.168 (0.250)
Obs.	2306	2306	2306
R-squared	0.021	0.010	0.080

Standard errors are in parenthesis

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

We have four columns showing three dependent variables on the right side, while the independent and control variables are on the left side. The standard errors are shown in the parenthesis, while the coefficients are without parenthesis. The relationship between the Msga, ROA, ROE, and TQ is significant ($p < 0.05$) and inverse, meaning that every unit increase in Msga, will decrease ROA, ROE, and TQ by 0.5, 0.4, and 2 units respectively. It means that Msga or increase in the discretionary expenses will have an inverse and negative effect on the accounting and market value of the firm.

The CEOExp and TMTSize are having a negative and significant relationship with ROA and ROE, meaning that it will impact the accounting-based performance of the firm. CEOExp is having insignificant and negative relation with Tobin's Q, while TMTSize is having an insignificant and positive relationship. Inside Outside CEO (IOCEO) is having significant and negative relation with ROA, ROE, and Tobin's Q, which means that the inside hire or promoted from within the organization CEO will not manipulate discretionary and other expenses and investments to show a rise in the earnings in short term. While on the other side an outside hired CEO would be myopic and will try to inflate earnings.

The control variables except growth are having a major effect on ROA, ROE, and Tobin's Q. It means that they will affect the myopic behavior of management. The industry or sector dummy variable is excluded by fixed effects, as this model assumes no variation across industries and considers the whole group as one unit. Therefore, we can say that irrespective of the industry, managerial myopia exists across all the firms and affect financial performance.

Discussion

The statistical results of the analysis reveal that the myopic behavior by managing and manipulating the discretionary expenses of selling, general and administrative expenses has an inverse and significant relation with the firm financial performance (Roychowdhury, 2006). It has confirmed our hypothesis that by decreasing the discretionary expenses, firm financial performance will increase, and the significant results show that management of discretionary expenses has an impact on the firm financial performance. Initially, we used OLS regression analysis, to test the impact of variables, and it revealed good results. But, because of its limitation and nature of our data, being the panel data, we deemed it necessary to test more sophisticated panel data estimation methods like fixed effects and random effects. We ran Breusch Pagan and Hausman Test to select the best among them and to rely our analysis on the same (Hausman, 1978; Breusch & Pagan, 1980). These tests revealed the fixed effects model as the most suitable for our study. The fixed effects gave the same results regarding Msga variable or discretionary expenses.

Our results further supported the hypothesis that CEOExp, TMTSize have significant relation, and negative impact on ROA and ROE, meaning that Financial Expert CEOs and variability in TMTSize will impact the firm financial performance, but on the opposite side. Financial expert CEO will manage expenses and other investments, while

TMT Size variability will reveal the short-sighted nature of the firm top management, resulting in myopic behavior to enhance the short-term earnings. These two variables are also having significant relation with Tobin's Q, revealing that it will impact the firm's market-based along with accounting-based performance measures (Porter et al., 2004; Cust'odio & Metzger, 2014).

Inside promoted or Outside Hire CEOs (IOCEO) impact is significant and negative which indicates that the outside hire CEO will try to inflate earnings, by myopic activities of curbing the different short term costs and expenses (Cannella & Lubatkin, 1993). The control variables however revealed that firm age has no significant impact on the performance, while firm size and growth will impact the profitability and performance of a firm. So their impact should be controlled to enhance the firm profitability. In other words, they are a check on the myopic behavior of the managers for enhancing the profitability through controlling these affecting variables.

Conclusion

We have used a panel dataset of 251 firms listed on the Pakistan Stock Exchange for the period 2009-2018. Based on our panel data analysis, we provide proof of managerial myopia and demonstrate how it affects firm financial performance. Our results revealed that managerial myopia equally affects Pakistani firms which in turn confirms the presence of myopic managerial behavior.

The companies listed on Pakistan Stock Exchange are under pressure to show good results, because of the frequent financial reporting and to build positive investor sentiments. The variables like TMTSize, CEO Exp have significant relation, supporting the myopic behavior exhibited by the firm top management to show good results (Ferreira, Ferreira & Raposo, 2011). The relation is negative, which means that they are taking short-term measures, which is inversely related to the firm financial performance. The IOCEO negative significance confirmed the previous literature (Cannella & Lubatkin, 1993; Laux, 2012) that outside CEO would be myopic, as he/she will take short terms measures to give good results for retaining his/her job.

Our study has elaborated the concept of myopia and we checked and confirmed previous literature on this topic, considering the corporate culture of Pakistan. We have added to the scant literature as regards the myopia behavior of Pakistani managers. Previous literature and surveys in different countries highlight that one of the main reasons for managerial myopia is the listing of firms on the stock exchanges (Graham, Harvey &

Rajgopal, 2005). The stock markets put pressure on firms to show good results, because of investors' sentiments and disclosure requirements of the short-term quarterly financial results (Anjum et al., 2012). Our results support the existing literature.

Limitations and Future Research

However, this research has certain limitations. We have selected some of the variables of managerial myopia in the context of Pakistan. There are other variables as well which can affect the managerial myopic behavior, and the same need to be investigated. We are generalizing our findings based on data of Pakistan, which in itself is limited to Pakistan, and applying them to other countries' contexts may be restricted, requiring the undertaking of similar researches in other conditions. Also, there is still a lot of room open for future researches in the related areas like the role of different governance structures, stakeholders' pressure, government policies and systems, manager's behavior about culture and society, and enhanced use of IT and decision support software's impact on the current and future decisions of management.

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