



## The Effect of Behavioral Characteristics of Managers on Corporate Financial Flexibility Moderated by Managing Director's Efficiency and Political Connections<sup>1</sup>

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### Introduction

Decision-making about financing, capital structure, and investment is quite crucial. Since they cause a variety of effects on the development of economic enterprises, the growth of profitability of companies, the increase of wealth of shareholders, and finally, the stock return. One of the crucial financial policies of companies pertains to their financial flexibility. The most important characteristics of managers include optimism, overconfidence, and myopia. Thus, the study investigated the impact of the behavioral characteristics (optimism, overconfidence, and myopia) of MDs on the financial flexibility of a company with the moderating role of MDs' efficiency and political connection.

### MATERIALS AND METHODS

In general, the data of 130 companies listed in the Tehran Stock Exchange from 2014 to 2018 were examined through multivariate regression. The data were collected by going through the financial statements of companies listed on the Tehran Stock Exchange. The data were selected through purposive sampling taking into account the following conditions.

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1. They should not be listed in the Tehran Stock Exchange prior to 2014 and the fiscal year ending on 20/03/2015.
2. The company's fiscal year should not be changed within the aforesaid periods.
3. The respective company should have had worked consistently in the period under research and there should not have been any trading halts lasting more than three months.
4. They should provide the financial information required for this research in the time interval between 2014 and 2018.

### Research Hypotheses

1. There is a relationship between the MD's optimism and the corporate financial flexibility.
2. The political connections modify the relationship between MDs' optimism and financial flexibility.
3. The efficiency of management modifies the relationship between the MD's optimism and financial flexibility.
4. There is a relationship between the MD's overconfidence and the financial flexibility.
5. The political connections modify the relationship between MDs' overconfidence and financial flexibility.
6. The efficiency of management modifies the relationship between MDs' overconfidence and financial flexibility.
7. There is a relationship between the MD's myopia and the financial flexibility.
8. The political connections modify the relationship between the MD's myopia and financial flexibility.
9. The efficiency of management modifies the relationship between the MD's myopia and the financial flexibility

### Research Model

The following regression model was used to measure the hypotheses of the research.

(1)

$$FF = \beta_0 + \beta_1 \text{optimism} + \beta_2 \text{political connection} + \beta_3 \text{efficiency} + \beta_4 \text{optimism} * \text{political connection} + \beta_5 \text{optimism} * \text{efficiency} + \beta_6 \text{Grow} + \beta_7 \text{Lev} + \beta_8 \frac{M}{B} + \beta_9 \text{Age} + \beta_{10} \text{size} + \beta_{11} \text{Year} + \beta_{12} \text{Roa} + \varepsilon$$

(2)

$$FF = \beta_0 + \beta_1 \text{overconfi} + \beta_2 \text{political connection} + \beta_3 \text{efficiency} + \beta_4 \text{overconfi} * \text{political connection} + \beta_5 \text{overconfi} * \text{efficiency} + \beta_6 \text{Grow} + \beta_7 \text{Lev} + \beta_8 \frac{M}{B} + \beta_9 \text{Age} + \beta_{10} \text{size} + \beta_{11} \text{Year} + \beta_{12} \text{Roa} + \varepsilon$$

(3)

$$\begin{aligned} \text{FF} = & \beta_0 + \beta_1 \text{myopia} + \beta_2 \text{political connection} + \beta_3 \text{efficiency} + \beta_4 \text{myopia} \\ & * \text{political connection} + \beta_5 \text{myopia} * \text{efficiency} + \beta_6 \text{Grow} \\ & + \beta_7 \text{Lev} + \beta_8 M/B + \beta_9 \text{Age} + \beta_{10} \text{size} + \beta_{11} \text{Year} + \beta_{12} \text{Roa} + \varepsilon \end{aligned}$$

## RESULTS AND DISCUSSION

The results suggested that the optimism of the MD has no impact on the flexibility of a company. However, the myopia and overconfidence of the MD influence the financial flexibility of a company. Considering that this relationship is negative, the higher the MD's myopia and overconfidence, the less they are concerned with the company's financial flexibility. Given that, the company with such management lacks proper financial flexibility to deal with the disparate situations that it encounters. In addition, the results indicated that the efficiency and political connections of the MD do not modify the relationship between the MD's optimism and financial flexibility. It signifies that the efficiency and political connections of the MD do not influence the relationship between the optimism of the MD and financial flexibility. The political connections do not modify the relationship between the overconfidence of the MD and the financial flexibility, yet the efficiency of the MD modifies the relationship between the overconfidence of the MD and the financial flexibility. The efficiency has a positive impact on the influence of the overconfidence of the MD on financial flexibility. The political connections modify the relationship between the myopia of the MD and financial flexibility. This modification has a positive effect on the impact of the myopia of the MD on financial flexibility. However, the efficiency of the MD does not modify the relationship between the myopia of the MD and financial flexibility.

## CONCLUSION

Hypotheses testing revealed that there was no significant relationship between the MD's optimism and financial flexibility. However, the relationship between MD overconfidence and MD myopia with financial flexibility was significant and negative. MD efficiency moderated the relationship between MD overconfidence and financial flexibility, whereas the political connections moderated the relationship between MD myopia and financial flexibility.

There is a negative correlation between the behavioral characteristics of this research and financial flexibility. The more the MD's myopia and overconfidence, the fewer measures they shall take regarding the company's financial flexibility. In light of these results, as well as the importance of financial flexibility, major shareholders and the board of directors are recommended to exercise more supervision concerning the managers' overconfidence and myopia to protect financial flexibility from encountering any challenges. Given that, the company shall be able to take appropriate

financial measures proportionate to the challenges and opportunities they face in case of need.

**Keywords:** Optimism, Overconfidence, Myopia, Financial Flexibility.

**JEL Classification:** G4, G39, G41.

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