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The Impact of CFO'S Managerial Characteristics on Firm Performance: Mediating role of Capital Structure Decision. Evidence from Sri Lankan, ListedFirms

M.Siraji
Department of Accountancy, Hardy Advanced Technological Institute

Abstract: *Capital structure is a significant area in strategic financial decision making of firms. Several characteristics,both managerial and none managerial, influence a firm's capital structure decision. However, managerial characteristics such as age, level of education, tenure, and functional trackwhich were researched extensively in this research area. The aim of this study is to investigate congruency between managerial characteristics of CFO's and capital structure decision, and the impact on performance of the firm. The study is of particular important since developments in the study of finance have shown that the financial decisions are being influenced by managers-shareholders conflict. By drawing from a vast body of research, the study will make a solid concept as well as provide a comprehensive understanding about how CFOs managerial characteristics such as age, level of education, tenure, and functional track, influence capital structure decision and firm performance.*

Keywords: *Chief Financial Officer (CFO), managerial characteristics, capital structure decision, firm performance, age, level of education, tenure, and functional track*

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I. Introduction

The capital structure decision is one of the most crucial aspects of managing a company since one of the tasks of the management of an organization is to increase the firm value. A growing company will usually need capital which can be financed by a mix of debt and equity (Matari, Swidi, &Fadzil, 2012). The job of the financial manager will be to find the optimal combination of funding that increases the value of the shareholders (Mak& Li, 2001). The differences in the variety of capital structure decisions in the market provide a valuable insight into the factors that influence such decisions. Managerial traits such as age, education level, and tenure of leadership are some of such important qualities (Peni, 2014). Managers with growth perception bias will likely overestimate the future earnings and will view external finance as unduly costly while managers with risk perception bias will likely seek external finance since they perceive the equity of the firm to be overvalued (Harkbarth, 2008).

While the traditional approach states that financial managers act in the interests of the shareholder, it is important to note that in modern times some financial decisions are influenced by manager-shareholder agency conflicts (Johl, Kaur, & Cooper, 2015). Such knowledge means that managerial characteristics play a role in determining the capital structure of the company. While some executives are very influential, others are relatively subdued in the conduct of their business (Harkbarth, 2008). Some executives and their successes of activities could be well known in the market and by the public in Colombo leading to an increase in the value of the firm once they are at the helm (Peni, 2014). By drawing from a variety of previous academic studies has concentrated on the relationship between human capital and company performance

(Memon, Mangi, &Rohra, 2009; McCarthy et al, 2011; Ahn et al, 2014). Hambrick and Mason (1984) found that the organization as a reflection of the demographic characteristic traits of its top managers and argued the importance of matching these with capital structure decision and firm performance. Matching characteristics of CFO's to capital structure practice, at the corporate (Graham & Harvey, 2001; Graham & Harvey, 2002; Bancel&Mittoo, 2004; Buferna, Bangassa& Hodgkinson, 2005; Sheikh & Wang, 2011; Ibrahima et al, 2012) has subsequently been investigated.By customizing an extended model (Hambrick and Mason, 1984; Strandholm et al., 2004) to accommodate the listed companies in Colombo Stock Exchange (CSE), this paper investigates congruency between managerial characteristics of CFO's and capital structure decision, and the impact onperformance of the firm.The managerial characteristics to be considered included age, level of education, tenure and functional truck, and three research questions are addressed:

1. Do managerial characteristics impact on capital structure decision?
2. Do managerial characteristics impact firm performance with mediating effect of capital structure decision?

II. Review of literature

The human resource refers to the full range of abilities, knowledge, and skills a person can exploit to yield the set result. Auw (2009) describe human capital as consisting of experience, education, and skills at a given point in time. According to Memon, Mangi, &Rohra (2009), the human factor has been ignored as a critical factor that determines company performance regarding the influence it has on capital structure decisions. Several previous studies hold the claim that the human capital factor should be put into consideration while evaluating an organization's strategy. The fundamental priority of any human resource strategy lies in securing and maintaining the organization's human resource to sustain the company's viability (Boxall, 1996). With this consideration, it becomes prudent to understand that managerial behavior has an impact on capital structure decision and firm performance. While firms may have relevant human capital, they, often, do not put into consideration the strategic impact of managers with regards to their capital management and designing of work.

The human capital refers to the knowledge and skills embodied in individual, then managerial characteristicsalso viewed as a specialized form of human capital concerning organization and capital structure decisions and affecting firm performance. Liu &Ravichandran (2007) hold the view that managerial characteristics such as age, experience, and education can help to predict the strategic outcome of finance-related decisions. In a related study, Ben-David, Graham & Harvey (2007) considered managerial overconfidence in making future forecasts about financial decisions, discovered that firms with overconfident CFOs have less flexible capital structure. Specifically, debt leverage and the proportion of long-term debt to total debt were higher in firms with CFOs' overconfident. Graham & Harvey (2007) explain the various methods in which the features of a CFO might affect the performance of the firm through the chosen form of capital structure.

Radell (1997) did a study on employee turnover within the management and discovered that it affected company gets deprived of necessary skills and experience to optimize capital growth. It is through continuous capital structure decisions that managers learn the best way to make use of available capital structure and executing commissioned work. Gupta and Govindarajan (1984) claimedthe need of managerial characteristics with job requirements by way of drawing a line on the significance of strategic decisions in an organization. Patterson et al., (1997) conducted a study on human resource and capital usage and concluded that managerial characteristics have a strong effect on a firm's performance, especially, when such a case is measured with regards to productivity or profitability.

Managers represent the unique organizational structure, and their character is directly reflected in the shape of the organization's strategic choice. Liu &Ravichandran (2007) goes further to state that managers play a significant role in the strategic organization of any business which translates to the general profitability as far as capital structure decision is concerned. Simonova, Bruna, &Ilmete (2011) argue that the concept of human capital in the context of public management necessitates and the understanding of financial capital and quality of managers to an effective output in the organization. To have efficient capital structures and significant profitability, managerial characteristics need to reflect a high level of dedication to delivering high-quality services to customer's satisfaction.

Demmke (2010) explains further that when there is the development of character strength among managers, integrity and accountability become the foundations upon which the company increases its share capital and expands its shareholding capacity in the market. Although there is the underlined significance of managerial characteristics to capital structure decisions, it is critically significant to highlight that training of the managers has an impact on their evaluation of conduct in business. What this means is that, as McCarthy, Grady, & Dooley (2011) put it, their involvement in strategic planning processes vary depending on their individual managerial characteristics. McCarthy, Grady, & Dooley (2011) indicate that effective leadership is a key element in good administration and mobilization of capital. Managerial characteristics are enablers of change and, therefore, there is the need to strengthen managerial capabilities to ensure better capital structure decisions and firm performance.

Managers who operate in an environment that is divergent with competing priorities need to have a firm grasp of effective policing strategies to produce civic-oriented results to the benefit of the company and end-users of services or goods delivered by the company. McCarthy, Grady, & Dooley (2011) emphasize that in the wake of globalization, leaders need to reshape their service leadership which begins with their personal characteristics as managers. The defining components of such a domain are that managers need to know themselves, embrace higher stress tolerance levels, practice clear critical thinking, tend to accountability, and demonstrate personal energy and passion towards achieving results. Consumers reform to managerial cultural changes which directly have an impact on the firm's performance. Therefore, there is a significant correlation between managerial characteristics and capital structure decisions that have an impact on firm's performance.

Sebaa, Wallace, & Cornelius (2009) maintains that the alignment of several demographic factors with strategic orientations improves performance resulting in better usage of available capital. Analoui, Moghimi, &Khanifar (2009) concludes that the decision to act entrepreneurially depends on interactions among individual characteristics as exemplified by a manager in a company. McCarthy, Grady, & Dooley (2011) conducted a study on the impact of human capital variables like age, gender, and education, and found that there were no significant differences in leadership domains across these variables. However, the experienced manager has been in the senior leadership position is influential regarding his/her long experience. As for the competence level, he found that managers in the middle level age group exhibited the highest score for competence. Furthermore, managers with high education levels were more concerned with personal technical proficiency and developing their skills to meet the changing business environment.

III. Hypothesis Development

Age

Age is expected to become an issue through the manager's way of working, dealings with his/her employees, behaviors with unprecedented situations, risk acceptance as reflected by uptake of new opportunities and new ideas, and other primary factors that affected by the age of the manager. Age of manager is expected to have an influence on capital structure decisions given the change in financing perspectives with age. Moreover, there is a significant decrease in flexibility and resistance to change as people increase in age. The business community attests to the fact that security becomes primary as people age as it will be evidenced by managerial practices executed by managers in that age bracket. They tend to avoid risky investments, especially, the ones necessitating significant strategic change within the organization.

On the other hand, young managers have a high-risk appetite. Also, older managers exhibit less confidence in the execution of their decisions and, thus, may lack the required conviction for providing managerial leadership for strategic change. This, by extension, affects the firm's performance regarding capital returns due to limited platforms of investment. Furthermore, the age variable is a good indicator of a person's non-work-related experiences. Individuals in the same age group have similar experiences and, therefore, share beliefs and attitudes regarding the different ways of exercising one's managerial duties and responsibilities. In the same context, Taylor (1975) indicates that old managers are less superficial information processors and decision makers. Lee, Yen, & Chen (2008) think that age impacts managerial characteristics and could diminish the manager's capacity to cope with the job of managing an organization. Thus, researcher propose the following:

H1a: Age of the manager has a significant negative impact on capital structure decisions.
H3a: Age of the manager has a significant impact on firm performance with mediating effect of capital structure decisions.

Level of Education:

Wiersema&Bantel (1992) showed a relationship between the level of education and receptivity to innovation. As noted by Ahn, Mortara, &Minshall (2014), a high level of CFO's education can be a measure of the initial human capital to an organization. Therefore, it can have a significant strategic impact on the organization's capital structure and performance. High information processing ability enables a person to overcome the effects of information overload together with analyzing complex knowledge that is appropriate to capital structure decision-making. Hatch & Dyer (2004) on commenting on human capital selection state that, managerial development through training enhances learning and its subsequent deployment improves firm performance. Thus, researcher proposes the following hypothesis:

H1b: Level of education has a significant positive impact on capital structure decisions.
H3bLevel of education has a significant impact on firm performance with mediating effect of capital structure decisions.

Tenure

Managerial tenures reflect a time-based process of understanding the external and internal environment of an organization. Hence, a longer tenure result more knowledge regarding a particular job and the context of capital structure decision. Also, an increase in the manger's tenure has a direct proportionality with the level of influence the manager has in the organization regarding policies implementation. They tend to run the organization in their pattern that is in line with their behavioral convictions (Liu &Ravichandran, 2007). Simsek (2007) explained that short-tenure managers lack sufficient awareness while evaluating strategic risks. Also, they are not prominent in the business community, lack legitimacy, and are untested in the most turbulent times, hence, are limited in consistent performance.

On the contrary, seasoned managers have attained deep knowledge of the company's environment, have a performance track record and relevant job skills. A long tenure to a manager reflects the extent to which a CFO has been integrated into the business networks of major stakeholders and establishes the capital resources and collaborations that enable the CFO to evaluate, nurture, organize, coordinate, and invest in risky initiatives. Thus, the CFO has an indirect influence on firm performance through a direct influence on the top management

with regards to their risk-taking tendencies. Umukoro (2009) indicates that long-tenure managers have great social cohesion resulting from a better understanding of organizational policies and procedural measures. Scott (2010) attempted to show that long tenure mangers have a great likelihood to risk aversion as they get committed to their long-tested models and become reluctant to take up change.
H1c: Manager's tenure has a significant impact on capital structure decisions.
H3cManager's tenure has a significant impact on firm performance with mediating effect of capital structure decisions.

Functional track

Functional track influences the managerial duties concerning execution of his/her organizational responsibility. The manager's perspective in light of his/her experience tends to overemphasize on specific company details that tend to get reflected on the organization's performance and capital structure decision. Lee, Yen, & Chen (2008) note that an increase in managerial longevity tends to improve the ability of the manager in providing superiors performance. They not only accumulate knowledge about organizational management but also acquire necessary skills to coping with the ever-changing environment.

Scott (2010) affirms that the functional track has a direct influence on the form of strategic leadership practiced by top managers. An analysis of the strategic role of manager's functional track makes it easy to differentiate performance based on the time spent at different managerial levels. Ahn, Mortara, &Minshall (2014) believe that functional areas help in the identification of managerial problems, especially, in innovation. Essentially, it means that having different cognitive perspectives to ways of information collection and interpretation contributes to strategic and organizational changes. Hence, researcher proposes the following hypothesis.

H1d: Functional track of manager has a significant impact on capital structure decisions.
H2: Capital Structure decision has a significant impact on firm performance
H3d: Manager's tenure has a significant impact on firm performance with mediating effect of capital structure decisions.

Conceptual model

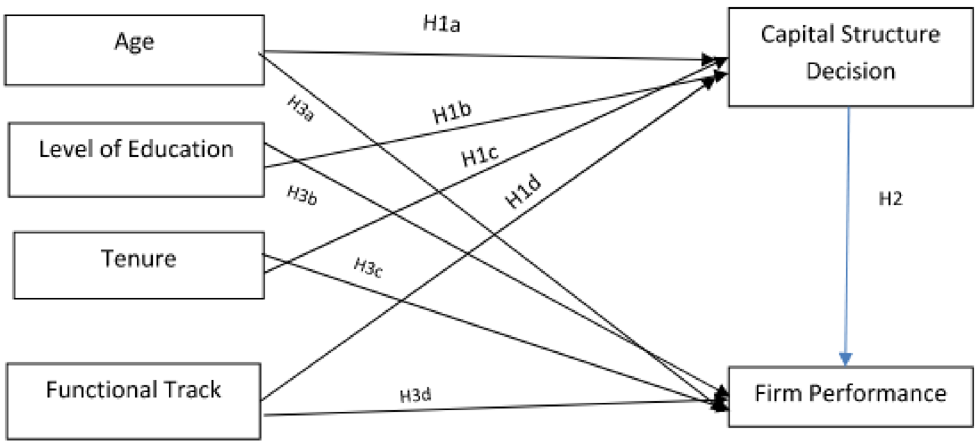

Figure 1: Conceptual model developed by researcher.

IV. Methodology

The targetpopulation of the study is the Chief Financial Officers (CFO) of listed companies in CSE .CSE has 295 companies representing 20 business sectors. Since only 295 companies are listed on the CSE in Sri Lanka, sample size of the study decided to consider the whole population. The finalized self-report questionnaire was e-mailed to all of the listed companies with a covering letter addressed to the CFOs of the companies, If no executive had the title CFO, then the questionnaire was sent to another senior executive (General Manger, director, or CEO) responsible for financial management. The questionnaire emphasizes the purpose of the survey, confidentiality and the benefits of the research for practitioners and academics. The questions measuring the capital structure decision and fir performance were borrowed from previous seminal studies (Daunfelt&Hartwig, 2014; Graham & Harvey, 2001; Graham et al, 2013;Gupta &Batra, 2009; Hermes et al, 2007; Verma,). However, important changes were made to the questionnaire in order to fit with the Sri Lankan context. The wording and structure of the questionnaire then was tested for its validity and reliability with few academics, seven companies from sample respondents. The questionnaire survey was carried during the period from Jan to June 2016. Timely reminders were sent to CFOs to elicit a high response rate. A overall of 105 completed responses were received, additional 31 responding to a reminder, making a total of 136 usable responses. This is a response rate of 46.1 per cent, consistent with the questionnaire ofDaunfelt&Hartwig (2014).

V. Data analyses

Spearman correlation coefficientconducted to test H1a, H1b, and H1cand H1d,. This is appropriateas the samples are large size. H3a, H3b, H3c and H3d were appraised using Structural Equation Model (SEM). For H2, one-tailed (directional) test ofthe Pearson correlation coefficient is tested.

Descriptive analysis of the survey responses

The summary statistics of demographic characteristics are present in Table I.The researcher is used the mean as the measure of central tendency and standard deviation as the measure of dispersion for this analysis. These two statistics were used to analyze the degree of occurrence or level of existence of each variable in the entire sample.

Table I: *Descriptive statistics of managerial characteristics*

Characteristics	N	Mean	SD
Age	136	32.45	6.56
Level of Education – MBA	136	3.32	1.21
Tenure	136	7.58	4.32
Functional truck	136	5.29	2.56

Analysis of correlation coefficients for managerial characteristics, capital structure decision and firm performance.

The effect of managerial characteristic associated on capital structure decision and firm performance using one-tailed tests for the resultant correlation coefficients (H1a, H1b, H1c and H1d). Asshown in Table II, age is not a significant characteristic in determining higher performance for CFOs, does not providing significant support for H3a. Level of Education did prove to be highly significant for Capital Structure Decisionand, thus providing strong support in favor of H1b and H3b. Finally, both organization tenure and functional truck were significant for Capital Structure Decision, providing significant support for H 1c and H1d,and Capital Structure Decisionhighly significant on firm performance in favor of H2.

Table II.

Hypothesis and correlation coefficients for capital structure decision, firm performance and managerial characteristics.

Characteristics	Dependent Variable	Hypothesis Support	Correlation coefficient
Age	CSD	H1a Accepted	-0.131 *
Level of Education – MBA	CSD	H1b Accepted	0.326**
Tenure	CSD	H1c Accepted	-.176*
Functional truck	CSD	H1d Accepted	0.137*
Capital Structure Decision	FP	H2 Accepted	0.342*

Notes: NS, not significant; CSD, Capital Structure Decision; FP, Firm Performance; *p, 0:05; **p, 0:01

Structural Equation Model (SEM)

SEM has been used to measure the direct effects of the independent variables on firm performance and also to check the mediating effects of the capital structure decision making on firm performance. Figure 2 reveals the direct effects of age, level of education, tenure and functional truck on firm performance without the mediating variable. It has been found that firm performance has a significantly positive impact with level of education($r = 0.433$, $p<0.01$) whereas age has a significant positiveimpact on firm performance ($r = .287$, $p<0.05$), tenure and functional truck have positive significant impact on firm performance ($r = 0.142$, $p<0.05$ and $r = 0.177$, $p<0.05$).

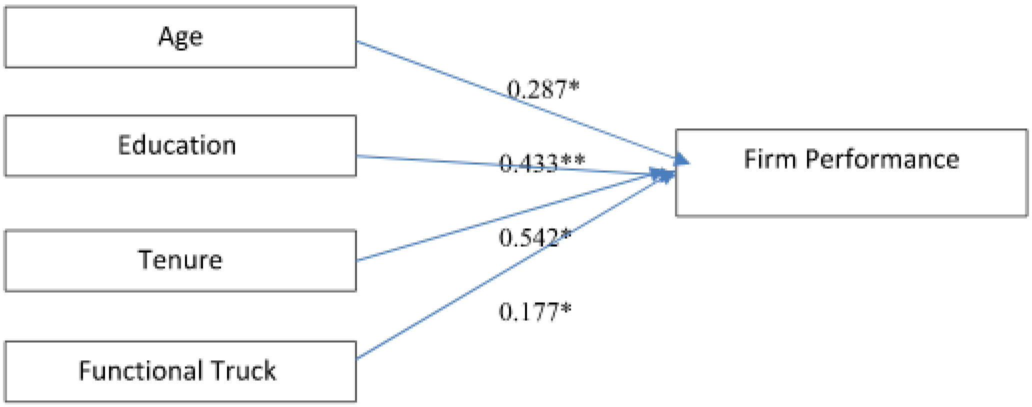

Figure 2: Structural Equation Model (Direct effects without mediation)

The second step is to check the impact of managerial characteristics on Firm Performancethrough the mediating variable of capital structure decision.

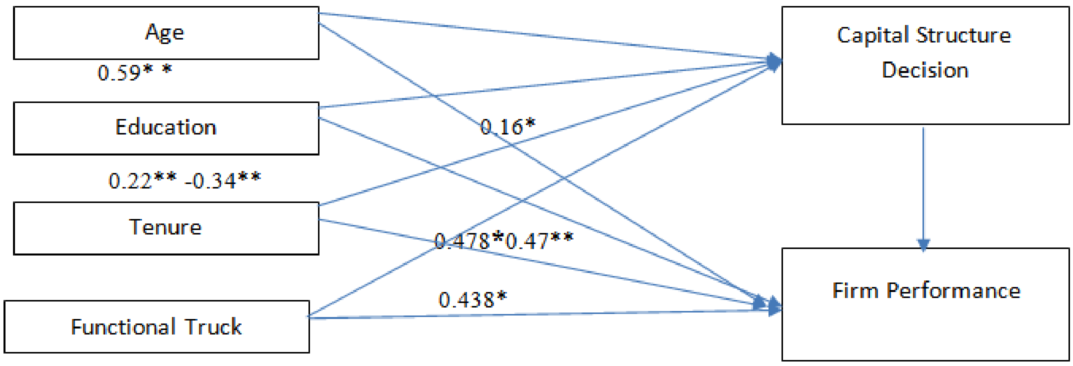

Figure 3: Structural Equation Model: Indirect Effects with Mediation

Figure 3indicates that age is positively (0.22) andsignificantly ($p<0.01$) related to firm performance when capital structure decision is included as a mediating variable. The regression weights has been substantially reduced (0.287 to 0.22) and but were highlysignificant. If the regression weight is reduced, but it is still significant, itprovides evidence of partial mediation (Baron & Kenny, 1986). The result confirmed that age has both direct effects on firm performance and indirect effects through partial mediation of capital structure decision, thus supporting hypothesis H3a.Also shows that education has a significantly($p<0.01$) positive (0.47) impact on the firm performance through the partial mediation of capital structure decision. The increased in the values ofregression weights from 0.433 to 0.47 and its significance clearly proves our hypothesis H3b. Although the regression weights of tenure have been reduced from 0.542 to 0.478; but the positive and significant ($p<0.05$)impact on firmperformance withcapital structure decision as a mediating variable indicates that capital structure decision partially mediates the relationship between tenure and firm performance supporting the hypothesis H3c.Finally functional truck also has a significant ($p<0.05$) positive impact on the firm performance (0.438) through mediation effect of capital structure decision. The increased in the values ofregression weights from 0.177 to 0.438 and its significance clearly proves our hypothesis H3d. The results of this study clearly show that the age, education, tenure andfunctional truck of CFOs significantly impact the firm performance through partial mediation of capital structure decision.

Table 2: Comparison of Direct and Indirect Effects

Variables			Direct Effects		Indirect Effects		Hypothesis
			Estimate	P-Value	Estimate	P-Value	Support
Age	→	Firm Performance	0.287	0.043	0.220	0.000	H3a Accepted
Level of Education	→	Firm Performance	0.433	0.003	0.470	0.006	H3b Accepted
Tenure	→	Firm Performance	0.542	0.035	0.478	0.041	H3c Accepted
Functional Truck	→	Firm Performance	0.177	0.256	0.438	0.037	H3d Accepted

VI. Discussion

The primary objective of this research is to examine the impact of the CFOs managerial characteristics on capital structure decision and the firm performance, with mediation effect of capital structure decision. More specifically, the characteristics considered were age, level of education, tenure, and functional track. It is expected that the managers with older age are likely to avoid debt and opt for equity financing while those in their junior years are likely to go for debt financing in raising capital for the firm. The study tested direct and indirect effects of the age related to the capital structure decision. The result consist with the finding Liu &Ravichandran (2007) , and Lee, Yen, & Chen (2008. Another trait considered was the level of level of education of the manager. Highly-educated managers tend to deploy complex strategies in managerial finance that directly affects the capital structure and firm performance and alsodeclared as critical factors by Ahn, Mortara, &Minshall (2014). Also, the study looks into the tenure of the CFOs which has an impact on the managerial experience. Experience is a unique factor that influences any decision made by a CFOs in an organization which is in line with the studyUmukoro (2009). Finally, the functional track reflects on the performance of the manager regarding the execution of their duties at different managerial levels. A look at all these factors is intended to give a clear picture to some of the managerial characteristics that have a significant impact on capital structure decision and firm performance, especially, at the listed companies in Stock Exchange.

VII. Conclusion

The study concludes that managerial characteristics are an important factor in determining the capital structure and impact on performance through mediation effect of capital structure decision of the firm. Specifically, age, tenure, functional track and level of education are important factors that affect influence capital structure decision and firm performance. A company should then be careful about the managerial traits to gain the benefits associated with a good team. The study, though done on listed companies at the stock exchange, is, also, applicable to bureaucratic organizations. This should be focused on the administrative side of it more than the technical side. Meaning that, making certain organization's decisions also has an influence on managerial characteristics, hence, indirectly affects capital structure decisions and firm performance. On the broader perspective, this study contributes to the identification of impacts of managerial characteristics on organizational performance, but its significance in corporate governance and growth of a company's profitability cannot be understated. To improve managerial work, there is need to put into consideration the skills, capabilities, and expertise that the manager possesses. The lack of such administrative capabilities negatively influences financial decision making, correction of deviations, and obstructs the smooth flow of work within a company. All these factors, together with the ones under study, play a part in the cumulative success of any organization. The study islimitedthat it has been conducted on CFOs and can be expanded to other functional manger through mediation effect of strategic option developed by Hambrick and Mason (1984). Also, the study can be further expanded in the future by using various other managerial factors such as overconfidence, optimism, risk aversion, etc.,having a significant impact on thefirm performance.Thus, this study provides a conceptual and empirical springboard for future work on other potentially important determinants of capital structuredecision-making and firm performance.

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