Human Capital, Management Quality, and Firm Performance

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Abstract

We make use of a panel data set from the BoardEx database on the quality of the management teams of 4635 firms during 1999 to 2010 to analyze the relationship between the management quality of firms and their long-run operating performance, current market valuations, and future long-run stock returns. We create a management team quality index using common factor analysis from various individual proxies for the quality of a firm’s management team, such as management team size, fraction of managers with MBAs, the average employment- and education-based connections of each manager in the management team, fraction of members with prior working experience in the top management team, and the average number of board positions that each manager serves on. We find that this index is positively related to firms’ long-run operating performance, current market valuations, and future long-run stock returns. We overcome hurdles related to endogeneity by using Vietnam War draft deferment rules for graduate education. Individuals graduating from college during this period enrolled into graduate degree programs for reasons unrelated to their intrinsic quality, i.e., to avoid getting drafted. Using this as an instrument, we find a causal relationship between our management quality index and firms’ long-run future operating performance, current market valuations, and long-run future stock returns. We also find that firms with higher management quality are characterized by larger levels of investment and investment growth. The relationship of management quality with firm valuation and performance is stronger for firms in R&D intensive, more competitive, financially constrained industries, and during periods of recession.

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