The Intersection of Emotional Intelligence and Corporate Financial Decision Making

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Highlights
- The correlation between emotional intelligence and corporate financial decision making is tested.
- A theoretical approach is used.
- It has crucial importance in decision making.

Abstract
Purpose: Financial decisions are now so complicated that financial managers need strong "people" skills to accompany their technical and financial strengths. Choosing the right mix of raw intellect and emotional balance can often determine not only how complete your financial proposals are but also how well received they will be by the management team that has to implement the concepts. Methodology: The study takes a theoretical approach to examine the relationship between emotional intelligence and financial decision making. Findings: The study concluded that intersection of emotional intelligence and financial decision making is very crucial for proper financial decision making processing. Recommendations: It was recommended that the financial team that has the best combination of skills and abilities, including analytical and emotional intelligence should be recruited.

Keywords: Financial Decision, Emotional Intelligence, Corporate Financial Decision

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I. Introduction

Financial decision making is most often perceived as how institutions and consumers interpret and apply professional investment advice, yet it appropriately should also include the challenges of organizational operations, including capital budgeting and evaluation. It is these latter obligations that are on the list task of every corporate chief financial officer (CFO). Every CFO depends on a team of talented specialists to propose the right mix of financial alternatives to the senior management team. They have often depended on traditional analytic measures to do so, such as discounted cash flows, measures of risk, and classic probability assessment. These measures are typical indicators of cognitive intelligence, which is itself only one component of general intelligence—and different completely from emotional intelligence (EI) and its complement, emotional competence (EC). EI’s interpersonal components affect the relationship between managers and subordinates, and there is some evidence to indicate that EI and EC intrapersonal components have a direct effect on personal task performance—perhaps even more so than does cognitive intelligence. However, there is also a negative side to EI, which may increase the risks for defective financial decisions. The prospect of choosing the right mix of raw intellect and emotional balance can often determine not only how complete your financial proposals are, but how well received they are by the management team that has to implement the concepts. The objective of this paper is to examine the relationship between emotional intelligence with financial decision making.

II. Literature Review

Emotional intelligence includes the ability to recognize what others are feeling and to control one’s own emotions. It is typically measured as a single trait that includes both interpersonal and intrapersonal characteristics. It is notable that EI does not contain the analytical, decision-making, and problem-solving traits found in the analytical and pattern components of cognitive intelligence (Lam and Kirby, 2002). Although measured as a single trait, EI is composed of four distinct factors:

- Identify emotions. This is EI factor that allows you to recognize how you and those around you feel.
- Use emotions. This factor follows on identification and is a trait that suggests that you can both generate emotion and reason with it in others.
- Understand emotions. This factor is the ability to understand complex emotions and movement among the four stages.
- Manage emotions. The ability to manage emotions within yourself and others is an EI factor that requires identification, use, and understanding before effective management can be accomplished, although emotional management can have positive and negative results for self and others.

After Salovey and Mayer’s original EI measure, Goleman proposed that merely having EI isn’t enough: One also needs to be competent in the application of EI and its several factors. His Emotional Competency Inventory (Goleman, 1995, 1998) includes completely different constructs than the four-factor structure of EI.

- Self-awareness • takes the EI identification of emotions a step further into the ability to conduct an accurate self-assessment, including recognition of one’s self-confidence and self-esteem competences. These self-consciousness traits make the presentation of our financial proposals and of the investment suggestions we make to the senior team viable. Without them, the audience may question whether the messenger is confident in the message, and even whether the proposal is worthy of consideration.
- Self-management • means that one has self-control, trustworthiness, integrity, motivation, and ambition. We look to others for their basic integrity and trustworthiness. Lack of either would indicate that the individual who proposes or makes the financial decisions cannot be trusted personally and therefore should not be engaged professionally.
- Social awareness • includes empathy and the ability to establish and maintain partnerships. Increasingly, the work environment goes us to reach beyond our department. Often, interactions are required within the organization in industrial relations, human resources, and marketing, and outside of it in commercial and investment banking.

These interactions depend, too, on our competence in relationship management, how well we resolve conflict and collaborate with others. Team cooperation and collaboration are how projects are accomplished. Handy (1990), formerly of London Business School, suggested that there are seven different kinds of intelligence. Although every person is likely to have some degree of each type, not everyone can be superior in every type of intelligence.
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- Analytical intelligence is the type measured in exams; this is the intelligence measure that we expect to witness in those who are often called book smart, and tends to be a minimal expectation of performance ability.
- Pattern intelligence is the ability to see and create patterns, often found in mathematicians, artists, and programmers—and, notably, also in financial analysts. We expect our financial analysts to be capable of quickly, is also unimportant for financial intuitive in making judgments and decisions, including the determination of the capability of her/his team members to effectively conceptualize and design concrete financial objectives. A financial leader must be intuitive in making judgments and decisions, including the determination of the capability of her/his team members to effectively conceptualize and design concrete financial objectives. Financial leadership depends on the ability also to motivate those employees toward the effective implementation of the organization’s financial goals.

Employees tend to be less cynical of leaders with high EI. Because he or she can address the team's individual needs with quantifiable emotional “soft” skills (such as problem solving and personal understanding), the leader is able to gain direct control over human resources by influencing team actions and optimizing overall effectiveness. A financial leader must be intuitive in making judgments and decisions, including the determination of the capability of her/his team members to effectively conceptualize and design concrete financial objectives. Financial leadership depends on the ability also to motivate those employees toward the effective implementation of the organization’s financial goals.

Cognitive intelligence improves individual task performance, because those who have cognitive intelligence can bring to bear their knowledge of the facts, procedures, and rules relevant to the technical requirements, the core of the job. Knowing how to develop a future cash flow projection, estimate required rates of return, calculate discounted cash flows, and develop presentations about capital expenditure (“capex”) to a management team requires technical knowledge. But IQ may account for as little as 10% to 25% of the variation among people’s job performance. Although intellect is important for effective financial decision tasks, emotional intelligence enables the intellect to function. Tasks that require anything other than working a financial calculator require both EI and EC. Indeed, several recent studies have found that EI is a better indicator of overall job performance, team project performance, and individual leadership, and becomes even more important as cognitive intelligence decreases (Carmeli, 2003; Chan and Schmitt, 2002; Côté and Miners, 2006; Motowidlo, Borman and Schmit, 1997; Rosete and Ciarochi, 2005; Schmidt and Hunter, 1998). We understand this interaction between cognitive intelligence and EI every day. Do we really want to have the “smartest person” (in terms of IQ) in our analyst group if that person has limited interpersonal intelligence and skill? Or would we rather have a team of relatively apt individuals who are comfortable with their own emotions and able to work effectively with others? This EI capacity allows us to develop leaders who can generate and maintain quality relationships throughout the entire organization based on trust and assurance. Without this mutual trust, there is no reason for employees to follow leadership guidance because there is no foundation for confidence in the leader or her/his direction.

Physical intelligence, the ability to lift heavy objects or run quickly, is also unimportant for financial decision making. Such abilities are worthwhile in many company tasks but usually not required for financial decisions, so the presence of physical ability is no guarantee of other talents.
- Practical intelligence is that ability that might let a person take a machine apart and put it together without instructions. But the person who can do something like this may not be able to spell the names of the parts or otherwise identify them. Neither practical nor physical intelligence is often demanded of individuals who generate material required for financial decisions (such as investment proposals, annual income statements, balance sheets, budgets, and cash flow projections).
- Intrapersonal intelligence refers to an ability to be in tune with one’s own feelings.
- Interpersonal intelligence is the ability to get things done with others. These last two types of intelligence are skills that Handy proposed that good managers have, in addition to analytical and pattern talent. They are more commonly reflected in Salovey and Mayer’s (1990) emotional intelligence measure—that subset of social intelligence that indicates that the individual has the ability to identify and control her/his own and others’ emotions, and to use that ability to direct her/his thoughts and actions.

Musical intelligence, which incorporates voice and instrumental talent. Although it is almost universally appreciated, it is not a type of intelligence usually in demand when specifications are set for financial offices. Yet the ability to compose, sing (well), and play complicated instruments is not a common skill or an ability that everyone can achieve (most of us will never be great musical performers).

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EI, the combination of interpersonal and intrapersonal skills, is the capacity to identify others’ emotions and to
manage one’s own emotions. Financial EI, then, is the ability to use and adapt emotions to achieve optimal
financial reasoning. Financial reasoning extends also to treasury functions and management of corporate
investments. We know that intuition can help when investors need information other than what is already known
from market history and analytics. However, emotional traders tend to make less use of technical analysis, and
emotions in advising can impact investors’ beliefs, and those emotional effects can be transmitted into prices.
Such emotional consequences tend to occur from inexperienced investors; experienced investors tend to be less
affected by emotional management patterns.

Technical investors prefer to use historical data with a goal to maximize expected wealth. Emotional traders
form their trading beliefs in a less formal manner, and they put different weights on diverse information sources,
with less weight for the market’s economic heuristics. There are five common emotional trading styles, which
often have deleterious results for investors:

- The disposition effect (Shefrin and Statman, 1985) proposes that investors tend to sell stocks that gained
  value and to hold on to stocks that have lost value—quite the opposite of the basic concept of buy low and
  sell high.
- In herd behaviour, commonly discussed in most financial investment commentaries, an investor imitates the
  observed actions of others or the movements of the market instead of following her/his own beliefs and
  information. Admittedly, it is nearly impossible for the individual investor to be a market mover, but there
  are notable occasions when institutional investors follow this same behavioural constraint.
- The availability heuristic, more commonly stated as “if you think it’s important, it is,” can be viewed as the
  expectation of future investment outcomes that will occur because of the recall of earlier similar results.
- The gambler’s fallacy is the presumption that if an investment went up in the past, the opposite is sure to
  occur in the future. Variations include the belief that if your number didn’t hit on the roulette wheel, it’s
  sure to come around in the future, or that if your lottery number selection didn’t hit today, it will in the
  future (even though random probability indicates exactly the opposite).
- The hot hand fallacy suggests that because one has experienced investment choice success in the past, one
  obviously has a hot hand and will have one again.

Although emotions and investment decisions have been considered since the early 1970s in behavioural finance
studies, there has been little research that investigates how and whether EI is or should be used for corporate
financial decisions—tasks such as annual budgeting, capex evaluations, capital structure choice, working capital
management for receivables and inventories, and dividend decisions. Finance textbooks all demonstrate the
requisite algorithms for each of these decisions, yet a modern CFO needs to wonder if math alone is enough.
Effective financial management should incorporate individual employee factors, which in turn are affected by
the leader’s EI. The leader of an organization’s financial group must grow the company’s “emotional capital” so
that issues of morale, organizational stress, staff turnover, and work-life balance are all improved—because
high EI is related to team performance and does have an effect on task out- comes (Boerner, 2011; Gladson
Nwokah and Ahiauzu, 2010).

EI is not always positive; there is a dark side, too. Corporate culture can create a win-at- all-costs orientation,
particularly if the corporate culture encourages and rewards such behaviour. It isn’t only corporate culture and
values that affect how EI is used. Individual abuse of EI can occur as well. Those with more power, either
because of circumstance or because of position or authority, are more likely to view others (and often see their
own subordinates) as a means to their own ends, and to thus use their power to advance their own self-interests
(and more likely than not, a pecuniary interest). This use of EI for the individual’s pursuit of personal gain is
expressed often through the disguise or expression of her/his emotions, by the expression and control of others’
emotions, and by controlling emotion-laden information (quarterly results, for example). Such management of
expression has been used by consumer bill collectors, who will generate anger among debt- ors in order to
collect the debt. There are other risks as well, which are highlighted by the proverbial adage that birds of a
feather flock together. Per- haps so, and perhaps selecting financial team candidates from the same schools,
with the same pedigree and the same rationale, is sensible from the perspective of technical analysis alone, but
similar values and demographic construction can generate “groupthink,” the preference for concurrence seeking
before all reasonable alternatives for the problem have been analyzed completely. Groupthink can take two
forms: The first, a collective avoidance, has a pessimistic view about the ability of the group to solve the current
issue success- fully. Symptoms of this type of groupthink are a defensive reaction to a potential failure and a
greater likelihood to concur with the group leader’s proposals (subjecting the group to the emotional
manipulation for the leader’s gain). The second type has an optimistic view of the group’s potential to
successfully resolve the current issue.
This overly optimistic group attitude tends to be more confident in its capacity to succeed than its actual abilities would suggest. For either type, groupthink will cause defective decision making, with the out-come of poor financial decisions and a low success probability. Cash budgets, accounts receivable collections, accounts payable disbursements, inventory purchases and quantity management, new debt, new stock issues, capex budgeting and funding, dividend choices, and the requisite monthly closings—these are the traditional tasks for the corporate finance officer. Yet these tasks are not done alone: a CFO depends on a team of seasoned and talented accounting and finance professionals to manage treasury and accounting functions, to generate and determine capex evaluations, to analyze dividend payment alternatives, and to develop and make these recommendations and results to the senior team. Classical recruiting and selection processes would suggest that only the best and brightest accounting and finance talent be brought into the organization. That is a hard argument to counter, but what isn’t clear is exactly what the best and brightest includes. If the best and brightest are those with the highest IQs, the best GPAs, and the highest scores on the CPA, CMA, CIA, or CFA exams, a CFO might be assured that his team would have the ability to perform the technical aspects of the job. But those technical requirements account for less than 25% of the performance variation in accounting and finance positions. Intrapersonal and inter-personal skills—the ability to understand and control one’s own emotions and the ability to work with others inside and outside of the department—are necessary amendments to technical skills, and weigh even more importantly for overall job performance than technical skills. The CFO as leader should be ever more conscious of incorporating mutual trust among her/his team, ensuring that her/his own EI is used for corporate gain and not suboptimal personal interests for anyone in the group, while simultaneously avoiding both pessimistic and optimistic groupthink threats. The intersection of EI and corporate financial decision making is clearly a need to ensure that EI skills are incorporated throughout the accounting and finance group to further group collaboration, enhance team performance, and expand overall financial decision-making acumen.

III. Conclusion and Recommendations
The intersection of emotional intelligence and financial decision making is very crucial because emotional intelligence includes the ability to recognize what others are feeling and to control one’s own emotions. This will enhance the proper reasoning of the decision maker as well as enhancing his ability to take proper financial decision. The study recommended that financial team that has the best combination of skills and abilities, including analytical and emotional intelligence should be recruited. Management should continually develop the professional capacities of the team’s financial acumen as well as to maintain their balance in personal competence (self-awareness and self-confidence) and social competence.

References
