CAN EMOTIONAL INTELLIGENCE MODERATE LOAN OFFICERS' JUDGMENTS AND DECISIONS?

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Abstract - Changes such as greater uncertainty and instability in financial and business environments, combined with unprecedented changes in accounting standards, have contributed to the increasing complexity of the decision process of professional users, including loan officers. Since previous studies have concluded that the judgments and decisions of professional financial statement users, including loan officers, can be influenced by some factors despite the users' level of professional sophistication, it seemed important to investigate whether variables other than those already examined in the literature influence loan officers' decision process. The purpose of this study is to explore whether emotional intelligence (EI) is a moderating variable in loan officers' information processing and to assess the extent to which EI moderates risk perception and credit granting decisions. This paper will help improve knowledge about the decision process of professional financial statement users, specifically loan officers, by bridging traditional decision making models used in accounting studies and the psychology literature on EI.

Key words - Loan officer, decision-making, emotional intelligence

I. INTRODUCTION

This study concerns the decision process of loan officers because of the important role they play in allocating capital to organizations, especially small and medium-sized businesses. Our objective is to study whether emotional intelligence (EI) acts as a moderating variable in loan officers' information processing and moderates risk perception and credit granting decisions. Changes such as greater uncertainty and instability in financial and business environments, combined with unprecedented changes in accounting standards, have contributed to the increasing complexity of the decision process of professional users, including loan officers. Some studies have concluded that accounting information disclosure methods can influence the judgments and decisions of professional financial statement users through functional fixation, regardless of the user's level of professional sophistication. It therefore seems relevant to investigate whether variables other than those already studied in the literature have an impact on loan officers' decision process. Although traditional economic models on decision making (DM) minimize the influence of emotions and assume that the beliefs and choices of economic agents follow rational principles to maximize their anticipated utility, many psychology studies have concluded that emotion can influence the judgments and decisions of individuals and that the management of emotions plays a role in financial decisions. The research to date shows that individuals who more easily identify the emotions that convey information on a situation and context and manage the emotions that can have disorganizing effects are in a better position to respond to the adaptation requirements of the external environment, such as DM. The theory of trait emotional intelligence highlights the capacity to identify, understand, manage and utilize one's personal emotions and those of others. Does loan officers' EI moderate their judgments and decisions when they analyze information on accounting? To answer this query, we refer to the process used by North American financial institutions to assess loan applications generally requires loan officers to study the overall risk rating (ORR) and overall trend rating (OTR) before making a decision on whether to grant or deny the loan (Treacy and Carey, 1998). The approval or denial of a loan requires a thorough risk assessment based on quantitative and qualitative information (Jankowicz and Hisrich, 1987). Lipshitz and Shulimovitz (2007) allude to financial and non-financial factors, the latter being non rational factors, according to the classical economic perspective. The approval or denial of a loan is a difficult decision, especially in the case of new clients, where information asymmetries between the account manager and the borrower can be extensive and conceal critical information (Deakins and Hussain, 1994). According to Wilson et al. (2007), the decisions of loan officers require more than the application of their institution's standards and procedures: loan officers must have considerable knowledge, aptitudes and personal qualities. Loan officers' and financial institutions' beliefs, policies and values contribute to judgment formation through a process driven by objective as well as subjective factors (Wilson et al., 2007). The issue of the influence of disclosing in the notes to the financial statements versus full recognition in the income statement and balance sheet has been examined in an experimental context by a number of researchers (for example, most recent first, Viger et al., 2008; Elliot 2006; Belzile et al 2006; Viger et al 2004; Hirst et al 2004; Anandarajan et al 2002; Maines and Mcdaniel 2000; Hopkins et al 2000; Ben Amar and Viger 2000; Hirst and Hopkins 1998; Bamber and Stratton 1997; Hopkins 1996; Sami and

Schwartz 1992; Gul 1987. They all came to the same conclusion, namely that presentation in the form of recognition significantly affected the reader's perception and decision making relative to presentation in the form of disclosure. Viger et al 2008 attributed this to readers being functionally fixated on up front reported numbers in the financial statements. Scores of studies on loan officers' decision process have been carried out over the past decades. They examine the impact of several factors that influence loan officers' judgments and decisions but do not take EI into account as a factor in these actors' information processing or DM. These factors can be classified into four groups:

1) Information characteristics;
2) Loan officers' functional characteristics;
3) Loan officers' personal characteristics; and
4) Organizational and situational factors. This study will help improve knowledge about the decision process of professional financial statement users, specifically loan officers, by bridging traditional DM models used in accounting studies and the psychology literature on EI.

II. LITTERATURE REVIEW

Traditional economic models on DM minimize the influence of emotions and assume that the beliefs and choices of economic agents follow rational principles, allowing them to maximize their anticipated utility (Camerer, 2003). However, Simon's (1976) concept of bounded rationality calls this approach into question by highlighting the existence of decision biases that lead to sub-optimal decisions (Charreaux, 2005). Emotions play an important role in behavioural bias (Grennwich, 2005), including decision bias. Biases, especially emotional ones, lead investors away from making the best decision based on substantive rationality (Ansiau et al., 2011). Studies have pointed out that emotions influence several types of judgments, including risk assessment (Gasper and Clore, 2000; Johnson and Tversky, 1983). According to Mikolajczak (2009), emotions help detect danger, prepare the body to face situations, accelerate and direct DM, guide social interactions and improve recollection of important events. Emotions serve to inform, enable action and support decisions. Seo and Barrett (2007) observed that investors who display more intense emotions perform better. Xu (2010) noted that pride and guilt experienced by managers influence their strategic DM, given that strong feelings of guilt are associated with greater integrity, lower risk taking and quicker problem solving, while higher levels of pride produce the opposite results. Referring to neuro-economic research, Sullivan (2011) indicates that emotions can influence financial decisions. One such study, conducted by Levav and Argo (2010), found that participants who were gently touched on the shoulder by a woman were more inclined to take greater risks than those who were not touched. Kuhnen and Knutson (2011) demonstrated that participants who viewed an image associated with a negative emotion make less risky investment decisions than those who viewed a neutral image.

In a study of the decision process of market analysts at four large London investment banks, Fenton-O'Creevy et al. (2010) concluded that the analysts' emotions, and their regulation, played a key role in their decision process. Delgado-Garcia et al. (2010) described how Spanish bank managers with somewhat negative emotional traits took less risky decisions. Other research based on neurological observations also supports the role of emotions in the decision process. Studies by the neurologist Damasio (1994) emphasized that emotions are as important to DM as rational thought is. One of the author's patients, after suffering a brain injury affecting the neural systems dedicated to emotions, could no longer make rational decisions because he was unable to weigh the various options, despite being able to discuss the pros and cons of different scenarios. According to Lazarus (1993), emotions can give meaning to adaptation imperatives and direct behaviour. Acting somewhat like a radar, they signal opportunity or need (Morin et al., 2015). Emotions let individuals prioritize objectives and actions from among a multitude of stimuli, supporting the cognitive process in its navigation of a complex and unpredictable environment (Oatley and Johnson-Laird, 1987; Winkielman et al., 1997). However, some emotions such as anxiety and fear can have disorganizing effects if they are not recognized and taken into account in the search for an appropriate response to adaptation imperatives (Morin et al., 2015). Some authors have described the differences between individuals who can or cannot recognize their emotional state (Frijda, 1986; Heelas, 1986; Lane, 2000; Levy, 1984; Sartre, 1962). Lambie (2007) indicates emotions are determinants of the actions of individuals who are unaware of their emotional state. However, unable to take emotions into account in their reasoning process, they temper their ability to control the undesirable actions arising from some emotions. Conversely, individuals who are aware of their emotions can be fully rational given their ability to decide which actions to take based on their emotional state (Lambie, 2007). How should emotional awareness be recognized and viewed? EI theory can be used to study this personal trait. EI refers to the ability to identify, understand, manage and utilize one's own emotions as well as the emotions of others. According to Petrides and Furnham (2001), EI is relevant to the study of emotions because it supports the notion that individuals who are aware of their emotions and can control and understand their own emotions as well as those of others are generally happier and more successful in their endeavours. Goleman (1995) suggests that EI may play a role in the decision process because individuals with greater EI are able to better

associate emotional experiences with thoughts and actions. Emmerling and Cherniss (2003) argue that individuals with low EI are more likely to produce desirable social responses and be influenced when forming a judgment. However, those with greater EI are less subject to this type of bias. The literature discusses two types of EI: EI as a cognitive ability (hereinafter referred to as ability EI, based on Mayer and Salovey's (1997) model) and EI as a personality trait (hereinafter referred to as trait EI, based on Petrides and Furnham's (2001) model). Petrides and Furnham (2001) describe trait EI as a set of personality traits, contrary to Mayer et al. (2004) who define EI as a form of intelligence, along with social, practical and personal intelligence, based on Gardner's (1983) theory of intelligences. According to Petrides and Furnham (2001), the fundamental difference resides in the method of intelligence assessment rather than the dimensions that constitute intelligences. Ability EI is measured by performance tests, while trait EI is assessed through selfreport questionnaires. Trait EI defines EI as a constellation of emotion-related dispositions capturing the extent to which individuals identify, understand, regulate and utilize their own emotions and those of others (Mikolajczak, 2009).

To understand the role of EI in financial DM, trait EI was selected. Petrides and Furnham's (2001) model consists of 15 elements derived from an analysis of earlier EI models and related constructs such as alexithymia, affective communication, emotional expression and empathy (Petrides, 2009) as well as assertiveness (Goleman, 1995), elements of social intelligence (Thorndike, 1920), personal intelligence (Gardner, 1983) and ability EI (Mayer and Salovey, 1997). As trait EI relates to behavioural tendencies and self-perceived abilities, it is relevant to use in personality frameworks (Petrides and Furnham, 2001). The 15 elements are classified under four factors (Mikolajczak et al., 2007). The first factor, well-being, consists of happiness, self-esteem and optimism scales and is aimed at assessing the individual's general affective state. The second factor, self-control, assesses how effectively individuals regulate their emotions, impulses and stress, and is associated with selfregulation. The third factor, emotionality, refers to emotional expression and indicates the subject's tendency to perceive his or her own emotions and the emotions of others. The last factor, sociability, is the use of emotional competencies in a social context. The authors added two further aspects to the model under the Other category, and these aspects are incorporated in the overall EI score. Experimental studies have demonstrated the impact of trait EI on judgments and decisions. Fallon et al. (2014) found that, regardless of stress level, individuals with a high level of trait EI are better at searching for information than those with lower trait EI. The results in Fallon et al. (2014) confirm the role of trait EI in the decision process through its significant impact on acquisition, i.e. the first stage of information processing.

Durgut et al.'s findings (2013) indicate that components of the first three dimensions of trait EI are significantly and positively correlated to student success and that trait EI influences the academic success of accounting students. Ansiau et al. (2011) conclude that the more individuals learn how to manage their emotions, the lower their aversion to loss is. In addition, the more they learn to use their emotions, the greater their cognitive flexibility, and the more they can assess their own emotions, the less prone they are to optimism bias. These results indicate that higher levels of EI are related to more effective DM. The results of Telle et al. (2011) show that individuals with higher levels of trait EI are less influenced by emotional indices, resulting in improved DM. Di Fabio and Palazzeschi (2008) suggest that individuals with less developed trait EI have more problems related to lack of information in their decision process and the search for information, mainly because of their inability to use their emotions in the problem-solving process and when searching for information for DM purposes.

CONCLUSION

The decision process of professional users, including loan officers, has become more complex because of greater uncertainty and instability in financial and business environments. Since previous studies have concluded that the judgments and decisions of professional financial statement users, including loan officers, can be influenced by some factors despite the users' level of professional sophistication, it seemed important to investigate whether variables other than those already examined in the literature influence loan officers' decision process. The goal of this study was to explore whether EI acts as a moderating variable in loan officers' information processing and to assess its potential moderating impacts on risk perception and credit decisions even if loan officers use a fairly standardized decision process. By doing so, this study contributes to the advancement of the literature by bridging traditional DM models on loan officers used in accounting studies and the psychology literature on the role of EI in the decision process.

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