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Relational Demography and Firm Financial Performance

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Description

A growing body of literature has highlighted the importance of the CFO position examined the rise of the CFO position among American firms from 1963-2000. The analysis pointed out a fundamental redistribution of the managerial roles in firms as a strategic response to environmental changes, “with greater relevance of financial considerations built into the executive structure and decision-making process”. Similarly, the global survey report, “A New Role for New Times,” released by a CFO research service in collaboration with KPMG in Singapore indicated. That finance functions are playing a bigger role in firms’ strategic decision-making processes today compared to five years ago. In general, this line of research has suggested that beyond their fiduciary roles tax, auditing, financial reporting, internal control, CFOs should also have significant responsibilities in assisting CEOs with strategic management. The furious competition and global economic turmoil in today’s business environment require top executives to make decisions on a robust fact base that includes insights into the underlying economics of some have suggested that CEOs outsource more of the strategic responsibility to CFOs who are in charge of the budget planning and controlling. CFOs can provide insights to determine whether any strategic movements proposed by the CEO are financially feasible, as well as quantify the risks associated with lack of success International Federation of Accountants Committee, CFOs also can give guidance to line managers on how to contribute to the firm’s goals (Favaro, 2001) and manage in such a way as to generate value for the firm (Dalton, 1999).

Financial Performance

Despite increasing acknowledgment of the importance of the CFO’s strategic partnership with the CEO (Heidrick & Struggles, 1998; Howell, 2006; Tulimieri & Banai, 2010), the roles of CFOs in some companies are still mainly focused on traditional financial management tasks (Hiebl, 2013). For example, Bremer (2010) and Lüdtke (2010) analyzed the job descriptions of the 86 CFOs working for the largest publicly traded German firms in 1998 and 2007. Their findings suggested that the CFO had responsibility primarily for traditional tasks and only limited responsibility for strategic tasks. Many similar findings Granlund & Lukka, 1998; Järvenpää, 2007 indicated that CFOs are increasingly working on strategic topics, but a radical transformation in their roles has not yet occurred. Such findings point to the fact that many CFO’s responsibilities still consist of rather traditional tasks such as financial accounting, treasury, and management accounting. To date, little research has been conducted to examine the effect of the strategic partnership between a CFO and CEO on a corporation’s financial performance. There have been a growing number of publications regarding the position of CFOs in recent years (Hiebl, 2013), but most of these studies haven’t addressed the CFO’s role in strategic management, choosing to focus rather on the CFO’s education and career background Collier & Wilson, 1994, CFO turnover Li, Sun, & Ettredge, 2010 or the CFO’s influence on accounting practices Gibbins, McCracken, & Salterio, 2007.

Management critics have even suggested that a CFO’s high involvement in management decision processes may deteriorate performance in his or her traditional fiduciary role, which may actually damage the firm’s financial performance (Indjejikian & Matejka, 2006; Loomis, 1999). It has also been suggested that CFOs are risk averse and tend to decrease investment in research and development (R & D), new projects, and advertising (Winston, 2014). Therefore, an empirical test of the influence of the CFO’s strategic partnership with the CEO on the firm’s financial performance is needed to add to the knowledge about the role of the CFO in a firm’s strategic management. In addition to concerns about the paucity of literature in this area, the study performed was further motivated by a commonly observed problem that the partnership between the CEO and the CFO is most often uneasy and ineffective. For example, it has been revealed that 40% of CEOs have actually fired their most recent CFOs (Dalton, 1999) due to claims by the CEO that the CFO lacked certain critical characteristics such as leadership, integrity, strategic vision, or communication skills. In contrast, from the CFO’s standpoint, “many CEOs are mavericks — they and they alone establish the strategic direction, and they expect other senior managers to get on board with no debate” (Banham, 2010). With these different perspectives, one may question the characteristics a CFO must possess to best facilitate the CEOCFO strategic partnership.

Background and Hypothesis

Previous research about top management team (TMT) composition provides insights on how to staff the team as a whole (Escribá-Esteve, Sánchez-Peinado, & Sánchez-Peinado, 2009; Nielsen, 2010; Patzelt, KnyphausenAufseß, & Nikol, 2008). However, emerging studies about dyadic relationships among TMT members suggest that any top executive’s effectiveness is mostly contingent upon the quality of their relationship with the CEO, since functional TMT members need to report directly to the CEO (Menz, 2012). Therefore, studies about the characteristics of the CEO-CFO ties are needed to understand what makes a CFO’s strategic partnership with the CEO successful. Taking all the above issues into account, the first objective of this study was to investigate the influence of the CFO’s strategic partnership with the CEO on the firm’s financial performance. Directly testing this relationship would contribute to the literature examining the role of CFOs by providing empirical evidence about the importance of the CFO in strategic management (Menz, 2012). Moreover, the relational demography of CEO-CFO ties was examined to reveal the effect on a CFO’s strategic partnership with the CEO, as well as the firm’s financial performance. By testing this directly, the present study contributed to the literature about functional top management team members by providing some direction on how to promote or select appropriate CFOs in order to enhance their strategic partnership with CEOs, which could further improve the firm’s financial performance.

The commitment, morale, and integration engendered by shared leadership among top executives has been suggested as being beneficial for a firm's financial performance Alvarez & Svejenova, 2005; Beal 2003; Denis 2012; Pearce & Zahra, 1991. Top executives' involvement in strategic decision-making processes can also help a firm solve difficult problems and generate creative ideas and multiple alternatives (Edmondson, Roberto, & Watkins, 2003). By sharing leadership with CFOs, CEOs can focus on their key external roles and devote more effort to scanning the environment, learning from outside parties.