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International work experience and compensation: Is more always better for CFOs?

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ABSTRACT

The CFO is increasingly considered the second most important executive in the firm after the CEO. Still, little is known about the factors that determine CFOs' compensation. Recently, it has often been claimed that, in MNCs, CFOs should have international work experience. But is a CFO's international work experience also reflected in his or her compensation? We combine human capital and social capital perspectives to account for both the upside and the downside of international work experience. We suggest that working abroad provides CFOs with valuable knowledge and skills which increase compensation; however, staying abroad for too long has an adverse effect due to losses in social network ties. We thus propose an inverted U-shaped relationship between CFOs' international work experience and their compensation. Furthermore, we suggest that this relationship is contingent on the characteristics of the CEO. In testing our hypotheses on a sample of the largest MNCs in Europe, we find support for the proposed relationships. Our study contributes to the literature on top management characteristics and executive compensation, specifically by providing a comprehensive understanding of how and when international work experience pays off for CFOs.

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1. Introduction

Over the last few decades, researchers have devoted considerable attention to the study of top managers and their compensation (Devers, Cannella, Reilly, & Yoder, 2007; Finkelstein, Cannella, & Hambrick, 2009; Gomez-Mejia, Berrone, & Franco-Santos, 2010). Whereas the majority of this research focuses on top management teams (TMTs) in general or on Chief Executive Officers (CEOs), Chief Financial Officers (CFOs) have gained more scholarly attention only recently (Menz, 2012; Uhde, Klarner, & Tuschke, 2017). This is surprising given the fact that the CFO is often considered the second most important executive in a firm, wielding a level of influence exceeded only by the CEO (Tulimieri & Banai, 2010; Zorn, 2004). While the importance of CFOs for their firms is increasingly acknowledged in the literature, scholars note that "we still know too little about the persons who occupy these positions" (Six, Normann, Stock, & Schiereck, 2013, p. 107). In particular, there are few insights about the characteristics that CFOs need to perform well in their jobs and that determine their compensation (Datta &

Iskandar-Datta, 2014).

With our paper, we shed more light on this issue by examining a CFO characteristic deemed to be vital for CFOs' job performance in multinational corporations (MNCs): international work experience. CFOs in MNCs have to manage firm financials that are increasingly international since sales, resources, operations and stakeholders are usually dispersed across various parts of the world (Carpenter, Sanders, & Gregersen, 2001; Ferreira, Massa, & Matos, 2010; Groysberg, Kelly, & MacDonald, 2011). Related scholarly and practitioner literature suggests that CFOs with international work experience might be better equipped to handle challenges stemming from internationalization (Carpenter, Sanders, & Gregersen, 2000; Ernst & Young, 2010; Piskowska & Trojanowski, 2014). It is often assumed that international work experience is not only beneficial for CFOs when carrying out their job but should also be rewarded and result in higher compensation (Financial Executive, 2012, p. 9; Michael Page International, 2012). However, there has been no systematic research on the relationship between CFOs' international work experience and their compensation levels. Hence, based on a sample of European MNCs, our study examines the following main question: *Is a CFO's international work experience associated with his or her compensation level, and if so, how and why?*

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Attention to this question is particularly warranted for the following two reasons: First, in practitioner-oriented literature, international work experience is often enthusiastically promoted as being advantageous for CFOs (Ernst & Young, 2010; Michael Page International, 2012). Relevant publications suggest that “without international experience, the CFO candidates of tomorrow have a gap on their résumés” (Ernst & Young, 2013, p. 31), or they even claim that “CFO pay [is] boosted with international experience” (Financial Executive, 2012, p. 9). But can the proposed benefits of CFOs’ international work experience be supported by empirical evidence? Second, and relatedly, there are theoretical arguments not only for beneficial but also for adverse effects of international work experience. In fact, two theoretical perspectives exist that provide contradictory predictions about the association between CFO international work experience and CFO compensation levels: the human capital view (Becker, 1975), which would suggest a positive association; and the social capital view (Kwon & Adler, 2014), which would suggest a negative association. In our study, we propose that the two perspectives can be reconciled and integrated (see also Georgakakis, Dauth, & Ruigrok, 2016): certain levels of international work experience can increase CFO compensation, but beyond a threshold, “too much” international work experience can decrease CFO compensation. Accordingly, we expect an inverted U-shaped relationship between CFO international work experience and CFO compensation levels. In addition, we posit that this relationship may be influenced by the characteristics of the CEO. Taking a contingency perspective, we argue that in firms headed by internationally experienced CEOs, both the advantages and disadvantages of CFOs’ international work experience may be magnified. Thus, we expect a steepening of the inverted U-shaped relationship.

We empirically test our hypotheses on a sample of CFOs of the largest firms in Europe. The European context is particularly suitable for investigating executives’ international work experience, as management in Europe is inherently international and cross-cultural (Calori, Steele, & Yoneyama, 1995; Kaplan, 2014). Our results support the hypothesized inverted U-shaped relationship between CFO international work experience and CFO compensation levels. We also find a moderating effect of CEO international work experience, which, as proposed, steepens the inverted U-shaped relationship.

Our study offers several contributions to top management and executive compensation literature. First, we theorize and empirically demonstrate that the relationship between CFO international work experience and compensation levels follows an inverted U-shaped form. Compared to previous research (e.g., Carpenter et al., 2001; Peng, Sun, & Markóczy, 2015), our approach allows a more nuanced perspective on the effects of international work experience, accounting for both positive and negative aspects of such experience. Second, our study advances theory in executive compensation as we combine human capital perspectives and social capital perspectives. We illustrate how international work experience shapes both human and social capital, and how this jointly affects compensation. Third, our study adds to the nascent stream of literature dealing with functional TMT members by advancing our knowledge of the CFO. In particular, we generate new insights into the determinants of CFO compensation by providing a comprehensive understanding of how and when international work experience pays off for CFOs. Fourth, this study contributes to research about the relationship between the CEO and CFO. We examine the fit between CEOs’ and CFOs’ international work experience, demonstrating how the impact of CFOs’ international work experience on their compensation is contingent on the CEOs’ level of international work experience.

2. Theory and hypotheses

2.1. The role and importance of the CFO

While decades ago CFOs were often described as mere “bean counters” (Zorn, 2004), their role has greatly expanded (The Economist, 2016; Groysberg et al., 2011; Uhde et al., 2017). Today, CFOs’ tasks include setting the firm’s financial policies, overseeing financial reporting processes, monitoring risks and cultivating relations with relevant stakeholders, such as investors, regulators, governments and rating agencies (Mian, 2001; Six et al., 2013). CFOs are also deeply involved in the development of corporate strategy and act as “key strategic partners” to the CEO (Hilger, Richter, & Schäffer, 2013; Tulimieri & Banai, 2010). Furthermore, CFOs’ stature has grown due to the increased importance of financial strategy to the overall success of a firm (Gore, Matsunaga, & Yeung, 2011). Consequently, the CFO is frequently considered as “second-in-command” or “co-leader” of the firm (Six et al., 2013; Zorn, 2004). This is mirrored in firms’ remuneration policies, as recent reports document a narrowing of the gap between CEO and CFO pay (Kosur, 2015; The Economist, 2016). Whereas CFOs need many qualifications and characteristics to perform well in their jobs (Uhde et al., 2017), international work experience has been highlighted as a particularly important characteristic of CFOs in MNCs (Groysberg et al., 2011; Johnson, 2015). In this study, CFOs’ international work experience is discussed from a human capital perspective (section 2.2) and from a social capital perspective (section 2.3).

2.2. The upside of CFOs’ international work experience: a human capital perspective

Human capital derives from an executive’s experiences and has been defined as “embodied knowledge, skills, abilities and other characteristics [...] that firms can put to productive use” (Mackey, Molloy, & Morris, 2014, p. 401). An executive’s human capital can be a determinant of his or her compensation to the extent that it is recognized and valued by the firm, or to be more precise, by the board, which is the decision-making body responsible for setting executive compensation (Boivie, Bednar, & Barker, 2015; Finkelstein et al., 2009). Prior research has found various human capital factors, for example deriving from education or career experiences, to impact executive compensation (Datta & Iskandar-Datta, 2014; Harris & Helfat, 1997). In today’s globalized world, executives of MNCs face considerable complexity resulting, for instance, from heterogeneous cultural, institutional and competitive environments and geographically dispersed resources (Carpenter et al., 2001; Piaskowska & Trojanowski, 2014). Executives with international work experience may be better equipped to cope with these challenges, as they are likely to have a better understanding of foreign markets, e.g., in terms of customer needs, business practices and legal systems (Ramaswami, Carter, & Dreher, 2016; Sambharya, 1996). Furthermore, international work experience increases executives’ strategic thinking competencies, allowing them to effectively manage MNCs’ international operations and seize global opportunities (Dragoni et al., 2014; Takeuchi, Tesluk, Yun, & Lepak, 2005). Hence, international work experience can be considered a valuable form of executives’ human capital (Carpenter et al., 2001; Peng et al., 2015).

We propose that international work experience is valuable for CFOs in particular. Today, CFOs’ tasks have a strong international component. Various factors drive the internationalization of firm financials and the integration of financial markets. For example, there has been a substantial increase in foreign portfolio investment, foreign direct investment, and in the number of firms that list

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