Journal of Corporate Finance 52 (2018) 168–191

Contents lists available at ScienceDirect

Journal of Corporate Finance

journal homepage: www.elsevier.com/locate/jcorpfin

How do chief financial officers influence corporate cash policies?☆

Chris Florackis*, Sushil Sainani

Management School, University of Liverpool, Chatham Street, Liverpool L69 7ZH, UK

ARTICLE INFO

Keywords:
Cash holdings
Chief financial officer
CFO
Corporate governance
Debt issuance

JEL classification:
G30
G32

ABSTRACT

This paper examines the extent to which Chief Financial Officers (CFOs) affect corporate cash holding policies. We construct an index (CFO index) that enables us to distinguish between "strong" and "weak" CFOs based on their ability to *influence* firm outcomes. We find that firms with strong CFOs hold substantially less cash than firms with weak CFOs, ceteris paribus. Importantly, the CFO effect documented in our study goes beyond the effect caused by the Chief Executive Officer (CEO) on cash holdings. Our findings provide the first direct empirical evidence that firms with strong CFOs are well positioned to hold less cash due to their relatively weak precautionary motive and superior ability to raise external financing during periods of financial stress. Consistent with an agency explanation, our results also show that strong CFOs fulfill a monitoring role in firms with higher agency costs.

1. Introduction

In recent years, the role of the Chief Financial Officer (CFO) has evolved considerably and has expanded beyond the traditional controllership and compliance functions. Despite competing priorities, liquidity management is commonly placed at the top of the CFO agenda. A global survey of CFOs from 29 countries reveals that three of the four most highly ranked functions that create firm value are activities related to corporate liquidity management (see Lins et al., 2010).[1]

Cash holdings provide an important means through which firms ensure liquidity (Almeida et al., 2014), especially during periods of financial stress and limited access to credit (Campello et al., 2011). The extant literature focuses almost exclusively on the role of

☆ We would like to thank the Editors (Douglas Cumming and Stuart Gillan) and two anonymous reviewers for their helpful comments and suggestions, which greatly improved the manuscript. We also thank Johannes Bersch, Cláudia Custódio, Marc Deloof, Ran Duchin, Andrew Ellul, Bill B. Francis, Mohamed Ghaly, Halit Gonenc, Udi Hoitash, Christodoulos Louca, Dev Mishra, Shawn Mobbs, Abdul Mohamed, Neslihan Ozkan, Ajay Patel, Dimitris Petmezas, Amedeo Pugliese, Raghavendra Rau, Kostas Stathopoulos, Yutong Xie, Ania Zalewska and conference/seminar participants at the EFMA Merton H. Miller Doctoral Students Seminar 2015 (Amsterdam), FMA European Conference 2016 (Helsinki), FMA Annual Meeting 2016 (Las Vegas), Multinational Finance Society 2016 (Stockholm), Portsmouth-Fordham Banking and Finance Conference 2016 (Portsmouth), World Finance Conference 2017 (Cagliari), Antwerp University, the University of Liverpool and the University of Manchester for their valuable feedback.

* Corresponding author.

E-mail addresses: c.florackis@liv.ac.uk (C. Florackis), s.sainani@liv.ac.uk (S. Sainani).

[1] Several recent surveys involving global CFOs highlight the prominent role of liquidity management, especially in the nearly 10 years since the financial crisis. For example, according to the 2014 Michael Page's "CFO and Financial Leadership Barometer", 48.2% of a sample of 2847 global financial leaders specify cash and liquidity management as a top company priority. The findings of several other surveys lead to similar conclusions. See e.g., "Strategic Priorities for UK businesses", Chartered Institute of Management Accountants and Robert Half Management Resources, 2010; "The Value of the Modern CFO: Board Directors' Perspective", Singapore CFO Institute and the ACCA, 2012; "Building the CFO Function: Roles and Responsibilities", Singapore CFO Institute and Singapore Management University, 2012.

https://doi.org/10.1016/j.jcorpfin.2018.08.001
Received 29 September 2017; Received in revised form 31 July 2018; Accepted 3 August 2018
Available online 13 August 2018
0929-1199/ © 2018 Elsevier B.V. All rights reserved.

CEOs and how they affect corporate cash and other financial policies.[2] For example, Bertrand and Schoar (2003) look at CEOs' managerial styles; Liu and Mauer (2011) focus on CEO compensation incentives; Custódio and Metzger (2014) study CEOs' financial industry expertise; Bernile et al. (2017) analyze CEOs' early-life disaster experience; Deshmukh et al. (2017) focus on CEO optimism; and Ferris et al. (2017) examine CEO social capital.

This study extends prior research by focusing on CFOs, who have received much less attention in the literature, and sheds light on the question of how they matter to corporate financial policies. In particular, we firstly analyze the effect of CFOs on cash holding policies. In order to reconcile some of our findings on cash holdings, we also examine the extent to which CFOs facilitate access to external finance, especially during crisis periods, as well as the CFO effect on other corporate financial and investment policies.

A key feature of our study is the construction of an index (rendered, CFO index), which attempts to capture the ability of the CFO to *influence* key financial policies. To construct our measure, we draw on the literature concerning the association between managerial characteristics and firm outcomes, and in particular, on studies that aim to conceptualize and measure the power and influence of boards and their directors (see e.g., Hambrick, 1989; D'Aveni, 1990; Finkelstein, 1992; Pettigrew and McNulty, 1995; Golden and Zajac, 2001; Castanias and Helfat, 2001; Adner and Helfat, 2003; Adams and Ferreira, 2007; Güner et al., 2008; Masulis and Mobbs, 2011; Bedard et al., 2014). Our index is constructed by combining six CFO-specific attributes which, as analytically discussed in Section 2.2, directly relate to the capacity of the CFO to exert influence over corporate decisions. These are: (1) board membership; (2) outside board directorship; (3) seniority (as proxied by age and/or tenure); (4) level of financial expertise; (5) pay status (if the CFO is among the top three paid executives); and (6) relative pay status (compared to the CEO). Based on the CFO index, we distinguish firms into those with strong (or more influential) CFOs and those with weak (or less influential) CFOs.[3]

We empirically investigate the effect of CFOs on corporate cash decisions using a large sample of UK firms over the period 1998 to 2011. The UK provides a unique setting for our empirical investigation. The first motivation behind examining a UK sample is the well-documented surge in the cash holdings of UK firms during that period and the resulting concerns of investors and policy-makers about possible adverse consequences for investment returns and economic growth.[4] Furthermore, CFOs in the UK, also commonly referred to as finance directors, are perceived to play a more important strategic role as illustrated by the fact that they sit on the board of directors in the vast majority of firms (above 85% in our sample). This particularly high percentage is in contrast to the US experience, where only about 11% of CFOs hold board positions.[5,6] The presence of CFOs in non-executive advisory boards outside their own firm is also remarkable in the case of the UK market (> 25% in our sample).

Our study reports several important findings. Our main analysis demonstrates a significant negative association between our CFO index and cash holdings, which suggests that firms with strong CFOs (i.e., high values of the CFO index) hold less cash, ceteris paribus. We verify the robustness of this finding through a series of tests. We firstly acknowledge that the influence of CFOs on cash holding decisions may be constrained by the countervailing influence of CEOs, especially in firms where CEOs are more likely to retain the decision-making authority over corporate policies within their control and delegate less to other high ranking executives - such as the CFO (see e.g., Adams et al., 2005; Graham et al., 2015). We provide suggestive evidence that the documented effect of CFOs on cash holdings goes beyond the effect caused by CEOs. In particular, we find that the CFO effect is not only observable in firms in which these policies are likely to be delegated to the CFO, but, importantly, also in firms in which financial policies are more likely to be driven by the CEO.

We then address the issue of endogeneity that may be driving our results. We document that our results remain robust to the inclusion of CEO-, board- and ownership-level controls and they also hold after controlling for fixed effects (such as firm, CEO and CFO). These tests alleviate potential concerns that our results are driven by omitted variable bias and/or unobserved time-invariant heterogeneity. We then deal with potential simultaneity issues due to matching (e.g., boards may appoint CFOs with particular characteristics that best fits their firms cash policies). We present several tests to show that endogenous CFO-firm matching is unlikely to drive our results. We first employ a propensity score matching technique. In this analysis, we compare firms with strong CFOs with a matched sample of peer firms with weak CFOs that are similar in terms of several observable firm characteristics. The analysis indicates that the firms with strong CFOs hold significantly less cash than otherwise similar firms with

[2] In the spirit of Opler et al. (1999), we refer "corporate cash policy" to the amount of assets held by a corporation in a liquid form; that is, cash and marketable securities. Precautionary-based (see e.g., Bates et al., 2009), transaction-based (see e.g., Opler et al., 1999) and agency-based motives (see e.g., Jensen, 1986) determine the way firms design their cash policy and the amount of cash and marketable securities held.

[3] In Section 2.2, we consider additional CFO attributes but they do not add significantly to the information contained in the benchmark version of the CFO index.

[4] For instance, a recent article in the *Financial Times* entitled "UK Companies Sit on Giant Piles of Cash" states that "The net cash position of FTSE 100 companies has risen from £12.2 billion in 2008 to £73.9 billion in 2013. These large cash piles, which are earning low returns, has increased shareholder concerns, who want companies to raise dividends, boost investment or pursue mergers and acquisitions to increase returns." (Published on: September 29, 2013). Another recent article in the *Financial Times* entitled "Carney's Salutary Change of Mind" states that "were (UK) companies to continue hoarding cash rather than investing, economic growth may well disappoint" (Published on: February 12, 2014).

[5] For example, a recent study by Mobbs (2018) reports that only about 11% of CFOs in US firms held a board position over the period 1997–2014.

[6] The CFO presence on boards is not entirely surprising in the UK given that the UK Corporate Governance Code encourages an appropriate balance of executive and non-executive directors on the board. For example, Principle B.1 of the Financial Reporting Council (2016) report states that "The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the boards decision taking." Whereas, the corporate governance and major reforms in the US promote board independence as a practice that enhances board effectiveness (e.g., Sarbanes-Oxley Act of 2002). A recent article published in the *Wall Street Journal* makes a similar point (see "A Waste of a Board Seat" (Published on: October 15, 2012)).

Download English Version:

https://daneshyari.com/en/article/9953030

Download Persian Version:

https://daneshyari.com/article/9953030

Daneshyari.com