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## POWER STRUGGLE BETWEEN CEO & CFO: WHAT IS THE IMPACT ON LARGE FIRMS' ENTREPRENEURIAL ORIENTATION?

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## POWER STRUGGLE BETWEEN CEO & CFO: WHAT IS THE IMPACT ON LARGE FIRMS' ENTREPRENEURIAL ORIENTATION?



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### ABSTRACT

This study investigates the impact of CEO and CFO power on large firms' EO. Grounded in the upper echelons theory, we hypothesize that CEO power is positively associated with EO, while CFO power is negatively associated with EO. Interestingly, our results, based on longitudinal data for 318 firms over 9 years, show that not only CEO power positively relates to EO, but also CFO power does. Moreover, we find that age heterogeneity within the TMT further strengthens the relationship between CEO power and EO. Our findings contribute to management and particularly entrepreneurship literature and provide important implications for practitioners.

### INTRODUCTION

In the face of aspiring startups, large corporates have to embrace an entrepreneurial orientation (EO) in order to remain competitive (Miller, 2011). Still, top management teams (TMT) of large firms are not always aligned on critical decisions. Google's withdrawal from the Chinese market due to censorship issues in 2010 is one example of an entrepreneurial strategic decision that resulted in a major power struggle among the firm's top executives. The question thus arises how executive power, particularly the power of Chief Executive Officer (CEO) and Chief Financial Officer (CFO), the two most powerful actors in TMTs (Zorn, 2004), influences large firms' EO.

EO refers to "processes, practices, and decision-making activities that lead to new entry" (Lumpkin & Dess, 1996, p. 136) and comprises the three sub-dimensions innovativeness, proactiveness, and risk-taking (Miller, 1983). The positive association of EO with firm performance (cf., Rauch, Wiklund, Lumpkin, & Frese, 2009; Saeed, Yousafzai, & Engelen, 2014) made scholars look for antecedents of EO in recent years. Drawing on the *upper echelons perspective*, latest research focuses on the role of CEO and TMT for firms' EO. Scholars for example show that moderate levels of TMT diversity enhance EO (Sciascia, Mazzola, & Chirico, 2013), find an inverse u-shaped relationship between CEO tenure and EO (Boling, Pieper, & Covin, 2015), and validate a positive association of CEO successions with changes in EO (Grühn, Strese, Flatten, Jaeger, & Brettel, 2016). Davis, Bell, Payne, and Kreiser (2010) demonstrate that managerial power strengthens the positive relationship between EO and firm performance, as powerful managers can more easily achieve buy-in from employees on beneficial entrepreneurial decisions.

However, research on the relationship between executives' power and EO, remains scarce. To the best of our knowledge, no prior study has empirically understood how the power of individual TMT members, particularly CEO and CFO power, influences large firms' EO.

From the power perspective, scholars have validated the important role of executive power for various organizational outcomes. Studies have for example shown that CEO power is positively associated with firm performance (Daily & Johnson, 1997; Krause, Priem, & Love, 2015) as well as with strategic change (Haynes & Hillman, 2010). Moreover, vertical power differences within the organization foster strategic change (Mitsuhashi & Greve, 2004), whereas power concentration in the TMT positively affects strategic change (Greve & Mitsuhashi, 2007). However, management research has not yet provided relevant insights on the interaction of individual TMT members' power with the composition of the entire TMT, particularly its diversity.

In summary, the combination of these two research streams, the power of individual TMT members and large firms' EO, provides a stimulating research opportunity. In this regard, the role of CEO and CFO power are particularly interesting as both are nowadays regarded as the two top executives (Zorn, 2004) and typically have different responsibilities (Hambrick & Cannella, 2004; Hiebl, Neubauer, & Duller, 2013) as well as characteristics (Graham, Harvey, & Puri, 2013). Depending on their power, different strategic priorities might therefore dominate the TMT and influence entrepreneurial decision-making. Theoretically grounded in the *upper echelon perspective*, this study therefore aims to answer the following two research questions: (1) What is the impact of CEO and CFO power on EO and (2) how does the composition of the TMT, particularly its diversity, influence these relationships? By answering these research questions, we contribute to management and entrepreneurship research in three ways: First, by empirically investigating the relationship between CEO and CFO power and large firms' EO, we provide an important contribution to entrepreneurship research, which so far lacks an understanding of the role of executive power in fostering entrepreneurial thinking and strategies. Second, we advance upper echelons literature by analyzing the interaction of individual executive power with the composition, particularly the diversity, of the entire TMT. Third, by applying computer-aided text analysis (CATA) to firms' letters-to-shareholders (LTS) in order to measure EO, we provide further evidence for CATA as a powerful measurement approach (Wales, 2016).

### HYPOTHESES DEVELOPMENT

The *upper echelons perspective* established the relationship between executives, strategic decisions, and organizational outcomes through executives' values, cognitions and perceptions, which are reflected in their observable characteristics (Hambrick & Mason, 1984). The authors further differentiate managers based on their functional backgrounds and the subsequent impact on decision-making as well as outcomes. Whereas they describe CEOs as executives who must take on a generalist view, they refer to CFOs as having throughput- or peripheral-function experience, which is not directly associated with the firm's core activities and increases administrative complexity. In this study, we assess how CEO power and CFO power, each individually, influence large firms' EO based on these different backgrounds and the resulting different priorities.

CEOs – with their generalist view – focus primarily on external, strategic and entrepreneurial activities (Hambrick & Cannella, 2004) and are typically visionary, risk-taking, as well as optimistic (Graham et al., 2013). For instance, the CEO's responsibilities include corporate strategy and development or mergers and acquisitions (Hiebl et al., 2013). These characteristics and responsibilities favor an innovative, risky,

and entrepreneurial posture. A powerful CEO will consequently dominate decision-making in a way that enhances EO. Hence, we derive:

*H1: CEO power is positively related to EO.*

CFOs with their primary background in finance and thus throughput- or peripheral-function experience tend to have “relative deficiencies in ‘hands-on’ experience” (Hambrick & Mason, 1984, p. 199). They primarily focus on finance-related responsibilities such as accounting, treasury, risk management, tax, and insurance (Hiebl et al., 2013). In consequence, CFOs typically increase administrative complexity, for example through implementation of planning and control systems (Hambrick & Mason, 1984). With regards to characteristics, CFOs are typically more risk-avoiding as well as less optimistic than CEOs (Graham et al., 2013) – attitudes that are obstructive to see the benefits from a rather long-term oriented EO. Hence, CFOs will likely not favor an innovative, risky, and entrepreneurial strategic posture. A powerful CFO will consequently dominate decision-making in a way that promotes cost control, avoids risks, and questions new expensive projects, therefore reducing the firm’s level of EO. We thus hypothesize:

*H2: CFO power is negatively related to EO.*

TMT heterogeneity can increase firms’ available capabilities, information, and perspectives, thereby enhancing creativity, experimentation, and information exchange (Amason & Sapienza, 1997; Amason & Schweiger, 1994; Milliken & Martins, 1996; Simons, Pelled, & Smith, 1999). In this study, we analyze the moderating role of TMT heterogeneity on the relationship between CEO power and EO as well as on the relationship between CFO power and EO.

Based on her / his characteristics and responsibilities (cf., Graham et al., 2013; Hiebl et al., 2013), a powerful CEO will guide the TMT towards an innovative, risky, and entrepreneurial strategic posture. In consequence, he will likely appreciate the breadth of ideas as well as the level of creativity and innovativeness stemming from TMT heterogeneity, for example based on executives’ functional backgrounds. While *organizational conflict literature* posits that certain types of heterogeneity, those based on observable characteristics such as age, provoke stereotypic perceptions, distrust, and hostility (Brehmer, 1976; Guetzkow & Gyr, 1954; Jehn, Northcraft, & Neale, 1999) a general experimental paradigm for the study of cognitive conflicts, and the principal results of the experiments conducted so far. The experiments have been concerned with the structure of conflict, sources of cognitive change, and effects of the characteristics of the policy task as generated in a situation in which 2 persons with divergent thoughts about a given policy task are required to work out agreements for a series of policy decisions. Results show that (a, thereby hindering decision-making and creativity, a powerful CEO can likely leverage her / his dominance to even take advantage of the diverse perspectives in such teams. A TMT exhibiting high heterogeneity, based on either functional background or age, will thus enhance the positive relationship between CEO power and EO. We therefore include two types of heterogeneity: On the one hand, functional heterogeneity to account for the interaction with the different functional priorities induced by CEO or CFO power. On the other hand, age heterogeneity to account for the role of executive power in preventing potentially detrimental effects from certain types of heterogeneity. Hence, we hypothesize:

*H3a: Age heterogeneity moderates the relationship between CEO power and EO: CEO power is more strongly associated with high EO when age heterogeneity is high than when it is low.*

*H3b: Functional heterogeneity moderates the relationship between CEO power and EO: CEO power is more strongly associated with high EO when functional heterogeneity is high than when it is low*

Contrary to the CEO, the CFO maintains a cost focus instead of an entrepreneurial focus and is more risk averse (cf., Graham et al., 2013; Hiebl et al., 2013). The enhanced creativity and innovativeness of a

heterogeneous TMT however favors an entrepreneurial posture and thus creates frequent disputes with the CFO, ultimately resulting in slower decision-making, stagnation, and a lower level of EO. We therefore derive:

*H4a: Age heterogeneity moderates the relationship between CFO power and EO: CFO power is more strongly associated with low EO when age heterogeneity is high than when it is low.*

*H4b: Functional heterogeneity moderates the relationship between CEO power and EO: CFO power is more strongly associated with low EO when functional heterogeneity is high than when it is low*

## METHOD

*Data and sample.* We obtained secondary data for firms that have been permanently listed in Standard & Poor's (S&P) 500 index between 2006 and 2015. After removing firm-year observations with missing values on at least one of our variables to enhance data quality and robustness, our final sample contains 1,125 firm-year observations. We calculate EO based on firms' LTS, which we obtained through company websites, online research, and investor relations departments. Moreover, we gathered our executive-level data from S&P Capital IQ's ExecuComp database and firm-level data from the Compustat database.

*Variables.* We define our dependent variable, EO, as a unidimensional construct consisting of the three sub-dimensions innovativeness, proactiveness, and risk-taking (cf., Wales, Gupta, & Mousa, 2013). In order to measure EO, we use CATA of firms' LTS – a prominent approach (e.g., Grünh et al., 2016) that is theoretically grounded in the *Whorf-Sapir hypothesis* and the *attention-based view of the firm* (Ocasio, 1997; Sapir, 1944; Whorf, 1956). We rely on the improved EO dictionaries of McKenny, Aguinis, Short, and Anglin (2016). Finally, we averaged our EO measure over time  $t$  and  $t + 1$ , which is common for dependent variables in the context of executive power (Nath & Mahajan, 2011) or corporate executive suite (C-suite). Our independent variables, CEO power and CFO power in the TMT, are operationalized as the logarithm of CEO shares and CFO shares, respectively, in relation to the average shares held by a member of the TMT (Daily & Johnson, 1997; Finkelstein, 1992). We calculate age heterogeneity, our first moderator, as coefficient of variation in age of all executives in the TMT (Bantel & Jackson, 1989). Functional heterogeneity, our second moderator, is operationalized as Blau's (1977) index of heterogeneity ( $1 - \sum p_i^2$ ), with  $p$  being the proportion of TMT members in a functional background and  $i$  the number of functional background categories. Finally, we control for several TMT-, firm-, and environmental-level variables that have been shown to influence a firm's level of EO.

*Model.* We rely on cross-sectional time-series data to test our hypotheses and use STATA's generalized estimating equation (GEE) model with an identity link function, a Gaussian (normal) distribution, and an autoregressive correlation structure (Ballinger, 2004; Liang & Zeger, 1986). Moreover, we use robust variance estimators to control for heteroscedasticity (White, 1980).

## RESULTS

We tested our hypotheses in six models. Model 1 contains the control variables only. Model 2 and 3 add CEO power and CFO power, each separately. Model 4 tests the integrated model for CEO and CFO power. Finally, model 5 and 6 include the moderating variables, again separately for CEO power and CFO power. Table 1 presents the results of our regression. Results indicate that CEO power is positively associated with EO ( $\beta = .082$ ;  $p < .01$ ), thus supporting Hypothesis 1. Surprisingly and contrary to Hypothesis 2, CFO power is also positively associated with EO ( $\beta = .092$ ;  $p < .05$ ). Furthermore, age heterogeneity in the TMT strengthens the positive relationship between CEO power and EO ( $\beta = .064$ ;  $p < .05$ ). However, the hypothesized moderating effects of functional heterogeneity in the TMT on the relationship between CEO

power and EO as well as of age and functional heterogeneity on the relationship between CFO power and EO are not significant. Hence, we find support for Hypothesis 3a, but not for Hypothesis 3b, 4a, and 4b.

### DISCUSSION & IMPLICATIONS

*Interpretation of results and implications.* This study empirically supports the importance of CEO power and CFO power for large firms' EO as well as the moderating role of TMT heterogeneity. In line with our hypothesis, our results confirm that CEO power is positively associated with large firms' EO. Thus, a powerful CEO has the ability to dominate decision-making in the TMT with his more visionary, risk-taking, and entrepreneurial focus (Graham et al., 2013; Hambrick & Cannella, 2004), thereby enforcing EO in the firm. Moreover, we find that age heterogeneity within the TMT strengthens the positive relationship between CEO power and EO. Interestingly, previous research has found a negative relationship between age heterogeneity and various organizational outcomes (Olson, Parayitam, & Twigg, 2006; Richard & Shelor, 2002; Zajac, Golden, & Shortell, 1991). Our results therefore suggest that the CEO's power might enable her / him to steer the TMT and avoid or at least moderate disputes, thereby being able to better utilize the various perspectives provided by TMT members from different age groups. Surprisingly, our results indicate that CFO power is also positively associated with large firms' EO. This is contrary to our hypothesis and suggests that power frees executives – at least to some extent – from the boundaries of their classical role profiles and makes them more entrepreneurial. However, we do not find support for an interaction of CFO power with age or functional heterogeneity within the TMT, which might be a result of the fact that the CFO is not heading the TMT as the CEO does. Whereas powerful CFOs thus promote EO, they lack the opportunity to leverage the creativity of a heterogeneous TMT. Overall, our results advance entrepreneurship literature by highlighting an important way to enhance entrepreneurial thinking and strategies in large firms – providing key executives with power in the form of company shares. On top of that, by highlighting that power allows CEOs to better steer and leverage the TMT, particularly if it exhibits a diverse age structure, we provide insights on effective governance mechanisms of large firms and thus contribute to TMT literature. These findings also entail important practical implications for boards of directors of large firms, when structuring and composing their TMTs.

*Limitations and Directions for Future Research.* Our study also contains limitations that provide avenues for future research. First, we rely on company shares as measure of executives' power, a common power measurement (Finkelstein, 1992). Future studies, however, should validate our findings with other types of power, for example more informal types such as executives' tenure or breadth of functional experience within the organization. Second, while we provide initial evidence for the proposition that power makes executives entrepreneurial, we encourage future research to validate these finding by testing the relationship for other, especially throughput-oriented, roles such as the Chief Operating Officer. Third, we provide evidence for the interaction of CEO power with the composition of the TMT in enhancing large firms' EO. As boards of directors typically have a control mandate over the TMT, future studies should also examine the influence of boards on the relationship between individual executives' power and EO.

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## APPENDIX

| Table 1 Results of regression analysis (dependent variable: entrepreneurial orientation [EO])   |       |   |       |    |       |   |       |     |       |     |       |    |
|---|-------|---|-------|----|-------|---|-------|-----|-------|-----|-------|----|
|   | (1)   |   | (2)   |    | (3)   |   | (4)   |     | (5)   |     | (6)   |    |
| Independent variables   | Base  |   | H1    |    | H2    |   | H1/2  |     | H3a/b |     | H4a/b |    |
| Controls  |       |   |       |    |       |   |       |     |       |     |       |    |
| Relative CEO-to-CFO age   | -.065 |   | -.097 | †  | -.043 |   | -.076 |     | -.123 | *   | -.048 |    |
| Median TMT age  | -.086 | † | -.079 | †  | -.085 | † | -.078 | †   | -.075 | †   | -.082 | †  |
| TMT power distribution  | -.019 |   | -.020 |    | -.061 |   | -.063 |     | -.025 |     | -.064 |    |
| TMT size  | .035  |   | .039  |    | .043  |   | .048  |     | .037  |     | .042  |    |
| Firm age  | .067  |   | .065  |    | .061  |   | .059  |     | .071  |     | .062  |    |
| Firm size   | .236  | * | .235  | *  | .240  | * | .239  | *   | .250  | *   | .257  | ** |
| Financial slack   | .083  | † | .085  | †  | .087  | † | .090  | *   | .087  | †   | .086  | †  |
| Past performance  | .018  |   | .022  |    | .014  |   | .018  |     | .022  |     | .014  |    |
| Environmental dynamism  | .008  |   | .018  |    | .006  |   | .015  |     | .016  |     | .005  |    |
| Competitive intensity   | -.002 |   | -.003 |    | .004  |   | .002  |     | -.012 |     | -.002 |    |
| TMT power   |       |   |       |    |       |   |       |     |       |     |       |    |
| CEO power   |       |   | .080  | ** |       |   | .082  | **  | .091  | **  |       |    |
| CFO power   |       |   |       |    | .089  | † | .092  | *   |       |     | .092  | †  |
| Moderation with TMT heterogeneity   |       |   |       |    |       |   |       |     |       |     |       |    |
| Age heterogeneity   |       |   |       |    |       |   |       |     | .035  |     | .014  |    |
| Functional heterogeneity  |       |   |       |    |       |   |       |     | .046  |     | .066  |    |
| CEO power x age heterogeneity   |       |   |       |    |       |   |       |     | .064  | *   |       |    |
| CEO power x functional heterogeneity  |       |   |       |    |       |   |       |     | .003  |     |       |    |
| CFO power x age heterogeneity   |       |   |       |    |       |   |       |     |       |     | -.022 |    |
| CFO power x functional heterogeneity  |       |   |       |    |       |   |       |     |       |     | -.046 |    |
| N   | 1125  |   | 1125  |    | 1125  |   | 1125  |     | 1125  |     | 1125  |    |
| Wald chi-squared  | 37    | * | 50    | ** | 41    | * | 53    | *** | 60    | *** | 47    | *  |
| <p>Notes. Standardized regression coefficients are reported for non-dummy variables; industry and year controls are included but not reported</p> <p>*** p &lt; .001; ** p &lt; .01; * p &lt; .05; † p &lt; .10</p> |       |   |       |    |       |   |       |     |       |     |       |    |