

# An Empirical Research on the Status and Role of Listed Companies' CFO in Corporate Governance

## UNE RECHERCHE EMPIRIQUE SUR LE STATUT ET LE ROLE DU CFO DES SOCIETES COTEES DANS LA GOUVERNANCE DE LA SOCIETE

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**Abstract:** Based on the related information disclosed in the annual report of SSE A-share, this paper makes an empirical analysis of the status and role of CFO in corporate governance. The result indicates that the status of CFO is low in corporate governance, and CFO still plays a traditional role. The result also demonstrates the main factors that determine the status and role of CFO are personal status and seniority. As a result, effective measures must be adopted to enhance the status and role of CFO from the perspective of corporate governance.

**Key words:** CFO, corporate governance, listed companies

**Résumé:** A partir des informations révélées dans le rapport annuel de l'action-A de la SSE( Shanghai Stock Exchange/Bourse des valeurs de Shanghai), l'article présent procède à une analyse empirique du statut et du rôle du CFO(Chief Financial Officer) dans la gouvernance de la société. Le résultat montre que le CFO jouit d'un statut bas dans la gouvernance de la société et joue encore un rôle traditionnel, et que les facteurs déterminant son statut et rôle sont ses statut personnel et ancienneté. A cet effet, des mesures effectives doivent être adoptées pour hausser le statut et le rôle du CFO dans la perspective de la gouvernance de la société.

**Mots-Clés:** CFO, gouvernance de la société, sociétés cotées

Modern corporate governance centers around financial governance, and its goal, to a large extent, is achieved through such kind of governance. As the person of the highest level responsible for the corporate's finance, CFO plays a very important part in the governance. Seen from the traditional financial role of CFO, he or she controls the accounting of the company and its organization as well as the cash and long term investment, thus he or she is the one who could coordinate the company's financial resources.<sup>3</sup> Seen from the responsibilities in the corporate governance system, CFO has undertaken the responsibilities concerning managing, law, governance, morality, management, and the responsibilities internally entrusted to the share holders and those externally to the board.<sup>4</sup> With the global development, CFO will function as a manager of strategic plans, resources, achievement evaluation, flow system and controlling,<sup>5</sup>

which is extremely important to elevate the value of share holders and to fulfill the corporate's target.<sup>6</sup> Nowadays, the corporate governance structure in our country is not perfect: the ownership structure of the share is not reasonable, the biggest share holder dominates the stock market, the board's governance efficiency is insufficient, governance committee exists only in a nominal sense, external surveillance mechanism is not sound, all of which are sure to influence the role of CFO, hence his or her display of this role in the corporate. We hold that responsibilities should be seen as equal to the status and right, and that only on the basis of certain status and right, can CFO function well in the corporate. From empirical perspective, the present paper analyzes the status and role of CFO in the company in order to know the place and the status quo of CFO in our country, and to analyze the factors that influence his or her status and the display of the role, to offer the empirical evidence for the enhancement of CFO's role in our country.

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## 1. THE DEFINITION AND DESCRIPTION OF VARIABLES

Item No9 in *CFO Clauses* stipulates that CFO shall assist the major corporate leaders by making decisions concerning activities of administrative institutions, such as production management, basic construction investment and so on. CFO shall participate in the drafting of the plans relating to the development of new products, innovation of technology, scientific research, prices of value, salary and rewards, etc; shall take part in the research and check of grave economic contract and economic agreement. CFO shall undertake managing responsibilities as a decision maker, thus he or she must be involved in the making of major decisions, including the resolutions concerning innovation, managing, financing, investment, and allocation.<sup>7</sup> Therefore, we think that two points are of great importance: first, CFO enters into top management and executive level; second, CFO enters into the level of the board that makes decisions. The two points determines the status and role of CFO in the corporate governance. Thus, we, in our research, assume dependent variable as JYC and DSH. The former is the layout of the senior financial administrators in top management and executive level. If there is a CFO existing in top management and executive level in the annual report of the listed company, then JYC equals to 1, otherwise 0; the latter is the whether there is a CFO in the board, if there is one reported in the annual report, then DSH equals 1, otherwise 0.

The factors that influence CFO's status and function in corporate governance may be ROA, the scale of company (SIZE), CFO's age (AGE), the share holding proportion of the biggest share holder (CR1), size of the board (BOARD), the ratio of total financial staff occupying the total number of its company (ACCOUNTANTS) and the circumstance of CFO's share holding (CHIGU). The indicators are described as follows: (1) ROA. The better the ROA, the higher CFO's status in corporate governance, hence more important role (in this article, net ROA is used as indicator for that of corporate's performance). (2) SIZE. The larger the size, the more problems are to be considered and solved by the corporate in marketing, and the more complicated the corporate's financial system is, moreover, owing to the larger size, more financial support will probably be needed during the strategic decision making, thus the CFO's status in corporate will be higher. (3) AGE. This is the most important factor that influences the CFO's status and role, since in China, one prominent feature of the enterprises is the overdue consideration of experiences and seniority, the elder, the longer one has stayed in the corporate, thus more experienced and higher the status. In addition, the market for managers is yet to come, so they are not free in mobility, thus age will have a lasting

influence on CFO's status in the corporate. (4) CR1. The share holding structure, which is selected as the variable that reflects the structure of ownership. The CR1 of the corporate that is listed is the basis of corporate governance, sound logical ownership structure is beneficial to the formulation of structure of corporate governance, otherwise it will harm the formulation. In our country, the monopoly of the biggest shareholder can easily be seen, which is sure to influence the structure of corporate governance, resulting "Internal Control"<sup>8</sup>, thus influence CFO's status in the corporate governance, it can be seen from here, that the higher the ratio of the share holders, the lower the status of CFO in the corporate governance. (5) BOARD, as is represented by the member of the board, the larger the scale of the board, more probably financial support will be needed, thus more attention will be paid to the CFO as well as his presence in the board. (6) ACCOUNTANTS, the total number of the accounts in the corporate, the larger the financial branch, the more financial affairs will be dealt with by this branch, and probably more important role CFO will play, hence higher his or her status in the corporate governance. (7) CHIGU, namely, whether he or she has held the shares and how many shares he or she has. Senior administrators play important part in the corporate, So adequate incentive measures should be adopted for rewards, and one among such measures is to allow the senior administrators to hold shares.<sup>[7]</sup> Therefore, it can be said that the corporate pays more attention to CFO and also that CFO is in higher position if CFO holds shares.

## 2. EMPIRICAL ANALYSIS

The datum concerning CFO of the listed companies in this paper are from CSMAR data resource of GTA company and 2005 annual report of the listed companies issued on the Juchao information web site. The number of the samples is 464 among 504 listed companies in Shen Zhen Stock Exchange, which is calculated by eliminating the companies whose data is not complete and also those treated by ST and PT.

### 2.1 The descriptive analysis of the status and role of CFO in corporate governance

Whether CFO can enter into top management level and board and whether he or she holds shares is one of the indicators to show whether his status is prominent or not.

Table 1 and Table 2 show CFO's presence in top management group and board in our country as well as the shares held by them. Table 1 shows CFO's presence in top management layer and board, from the table 1, it can be seen that among the total sample, 368

<sup>7</sup> State Branch, General Accountants Ordinance[S], 1990.

<sup>8</sup> Hui Xu, 'Discussion of the Ownership Structure of China's Listed Companies,' *Commercial Research*, Oct. 2005.

companies' CFO have entered into the top management group, occupying 79.3 percent, but still 20.7 percent of CFO have not done that. From here, it can also be seen that there are still some companies who have not had clear acknowledgement of the role of CFO played in the corporate governance, deeming that CFO plays no role or a weak one, and that CFO should stand by in relation to decision making and the companies' strategic development. It can also be seen from Table 1, that among 464 companies, only 19.6 percent of CFO have shown their presence in the board, but among 368 companies whose CFOs have entered into senior administrative level, only 91 companies CFO have presented in the board, a wealth of companies' CFO have been refused by the board. The CFO Clauses in our country stipulates that CFO shall be a member of administrator in the company, CFO shall take a leading role in the activities such as financial management, cost management, budget control, accounting auditing, accounting governance, and so on; participate in the analysis and decision-making concerning the important economic problems, CFO shall take part in drafting the plans regarding the development of new products, innovation of technology, value of the commodity, salary and reward etc.; shall be involved in the study and check of grave economic contracts and agreements. It can be seen from here, however, that CFO's status is comparative low in corporate governance, no mentioning their participation in decision making, proposing the companies' development strategy.

It can be seen from Table 2, that among 464 companies, 74 companies' CFO has held shares, occupying 18.97 percent of the total sample; among 368 companies whose CFO have shown their presence in top management group, only 73 listed companies' CFO have held shares, occupying 19.84 percent. Generally

$$\ln \frac{P(JYC=1)}{1-P(JYC=1)} = \alpha + \beta_1 \times CR1 + \beta_2 \times BOARD + \beta_3 \times SIZE + \beta_4 \times CHIGU + \beta_5 \times ROA + \beta_6 \times ACCOUNTANT + \varepsilon \quad (1)$$

The variables are explained as follows:

$\alpha$ : constant of equation;

$JYC$ : the dummy variable, if there is a CFO in top management group of a company,  $JYC$  equals to 1, otherwise 0;

$\varepsilon$ : error.

Table 4 shows the results of logistic regression analysis of the pattern, and from it we can see:

① The ratio of the financial members to the staff member of the corporate has a significant effect on whether the CFO can enter into top administrative group. The reason may be that the larger the financial section, the stronger the decision-making of financial system, thus the higher status of CFO in the corporate governance, the easier is he or she to enter into top administrative group.

speaking, if CFO holds the shares of that company, it can be said that CFO has a higher status in that company, however, a majority of CFO has not held shares, which shows the low status of CFO in corporate governance in our country.

## 2.2 The LOGISTIC Regression Analysis of CFO's Status and Role in Corporate Governance

### 2.2.1 The empirical analysis of whether CFO can enter into top manager group

#### 2.2.1.1 The descriptive analysis of whether CFO enters into top manager group

It can be seen from Table 3, that there is great difference between whether CFO enters into top group or not on the three indicators, namely ROA, CHIGUQK and ACCOUNTANT. The ROA and CHIGU of companies where CFOs enters into top manager group is obvious higher than those of companies where CFO does not, and so is the ratio of accounts to the whole staff member of the company. The effect of CFO's share holding on whether he or she can enter in marketing group can also be reflected in Table 2. From Table 2, we can also see that there are 73 CFOs who hold shares, however, among the corporates where CFO does not enter, only 1 CFO holds share. Thus it can be predicted that the three indicators (ROA, CHIGU and ACCOUNTANT) exert great influence over whether the CFO can enter into administrative group.

#### 2.2.1.2 The LOGISTIC analysis of whether CFO enters into the top management group

We use the model shown as follows shows to carry on the regression analysis:

② The condition that whether CFO holds share or not influences, to a great extent, whether CFO can enter into top group administrative or not. It can be said that CFO has a higher status in the company and can be easier to enter into top administrative group if he or she holds share.

③ The company's performance has a negative influence on whether the CFO can enter into top administrative group. From Table 4, we can see that the performance of the companies whose CFOs enter into top administrative group is better than those whose CFOs do not. However, with the improvement of company performance, CFO do not easily enter into top administrative group, which indicates that the companies think there is not close correlation between the performance improvement of company and the CFO, under such circumstances, the possibility of CFOs' participation in administrative decision becomes

very low.

④ The correlation of whether CFO enters into the top management group to shares held by the biggest share holders, to size of the board and the sale of the company is not obvious. In corporate governance of our country, the phenomenon of "Internal Control" can easily be seen, which may be one of the factors led to CFO's low status.

From mentioned above analyses, we conclude that the CFO's share holding condition and the size of financial section influence to a large extent whether the CFO can enter into the top administrative group or not, in other words, CFO's personal status and the scale of financial section determine whether CFO can enter into the top management group or not, which indicates that the company has not realized the important role of CFO

$$\ln \frac{P(DSH = 1)}{1 - P(DSH = 1)} = \alpha + \beta_1 \times CR1 + \beta_2 \times BOARD + \beta_3 \times SIZE + \beta_4 \times CHIGU + \beta_5 \times ROA + \beta_6 \times AGE + \beta_7 \times ACCOUNTANT + \varepsilon \quad (2)$$

The variables are explained as follows:

$\alpha$  : constant of the equation;

JYC: the dummy variable, if there is a CFO in top administrative group of a company, JYC=1, otherwise 0;

$\varepsilon$ : error.

Table 6 shows results of the logistic regression analysis of whether CFO enters into the board. It can be seen : CFO age, the condition of share holding, the scale of company and the total number of the accounts in the corporate influence whether CFO can enter into the board. Generally speaking, the elder, the more experienced, the more prestigious is the CFO in companies, hence the greater the possibility for CFO to enter into the board. The correlation between the company scale and CFO's entering the board is negative, which may be due to many large companies come from some large state-owned enterprises which are restructured, and whose internal control and administrative levels are obvious, but smaller-scale corporate governance is relatively flexible; There also exists a negative correlation between the ratio of finance staff to whole members of the company and CFO entering the board, which reflects that CFOs play their roles as administrators only in areas such as operations of financial section and accounting information-processing, if the size of financial section is very large, CFO must undertake more responsibilities, thus he or she is permitted to enter top administrative group. This shows companies have not realized the importance that CFOs should join in the board and participate in the decision-making beyond the financial section's function. Moreover, the proportion of the shares held by the biggest share holder, the size of the board and ROA have not exerted significant influence on whether CFO enter into the board.

in participating in administrative decision, creating value and formulating developmental strategy.

## 2.2.2 The empirical study of whether CFO entering the Board

### 2.2.2.1 The descriptive analysis of whether the CFO enters into the Board

As can be seen from Table 5, the age of CFO, the amount of shares held by CFO and ROA of a company where CFO is a member of the board is significantly higher than those where CFO is not .

### 2.2.2.2 The LOGISTIC analysis of whether CFO enters into the board

The model shown as follows is used to carry on the regression analysis:

## 3. CONCLUSIONS AND SUGGESTION FOR FURTHER RESEARCH

We can draw the following conclusions from the above analysis: first, age and the condition of share holding are the main factors which affect whether CFO can enter into the board, which indicates that the status of CFO in corporate governance is mainly determined by his or her status or seniority rather than the role that CFO should play; second, the bigger the size of financial sections, the lower the probability of CFO to enter into the board. This shows that the CFO's role has been limited to the area of accounting systems and decision-making. CFOs still play a traditional role as controller, and only supply the limited support for decision-making. Under such circumstances, it is almost impossible for CFO to participate in strategic decision-making and create company's value. As a result, we must take effective measures to enhance the status and role of CFO in corporate governance. In the long run, we should formulate a comprehensive and integrated system; in the short run, it is very necessary to amend the "General Accountants Ordinance" to restructure and replenish CFO's responsibilities. In this way, can CFO's role in corporate governance be put to full display.<sup>9</sup>

<sup>9</sup> Huihao Shu, *The Thinking Over Perfecting China CFO System*, Oct, 2004.

**Table 1. CFO's entry into marketing layer and board**

	Qty of entry	Qty of non-entry	Ratio of entry (%)
Entry into top management level (N=464)	368	96	79.3
Entry into board(N=464)	91	373	19.6
Entry into both top management level and board (N=368)	91	277	24.7

**Table 2. The condition of CFO's share holding**

	Holding shares	Not holding shares	Ratio of share holding (%)
Overall share holding (N=464)	74	390	18.97
Share holders entering into top management level (N=368)	73	295	19.84
Share holders entering into board (N=91)	28	63	30.77
Share holders not entering into marketing level (N=96)	1	95	1.04

**Table 3. The descriptive analysis of CFO entering top management level**

Variable	Mean	
	JYC=1(N=368)	JYC=0(N=96)
<i>BOARD</i>	9.88	9.76
<i>ROA</i>	.01260	-.02200
<i>SIZE</i>	21.057382	20.954015
<i>CRI</i>	41.7331	39.7242
<i>CHIGU</i>	2846.35	944.4
<i>ACCOUNTANT</i>	4.25	3.12

**Table 4. The logistics regression analysis whether CFO enter senior administrators level**

Variable	<i>B</i>	<i>Std. Error</i>	<i>Wald</i>	<i>df</i>	<i>Sig.</i>	<i>Exp(B)</i>
<i>Intercept</i>	-.593	3.095	.037	1	.848	
<i>CRI</i>	-.003	.007	.191	1	.662	.997
<i>BOARD</i>	-.001	.051	.001	1	.977	.999
<i>SIZE</i>	-.019	.153	.016	1	.901	.981
<i>CHIGU</i>	0.2157	1.017	9.639	1	.002**	.043
<i>ROA</i>	-1.983	.985	4.052	1	.044**	.138
<i>ACCOUNTANT</i>	0.121	.065	5.428	1	0.038**	0.423

Note: \*\*, \*\* and \*\*\* indicate respectively the two-tailed significance probability is 10%, 5%, 1%.

**Table 5. The descriptive analysis whether CFO enter board**

Variable	Mean		
	<i>DSH</i> =1 (N=91)	<i>JYC</i> =1, <i>DSH</i> =0 (N=277)	<i>JYC</i> =0 (N=96)
<i>BOARD</i>	10.08	9.81	9.76
<i>ROA</i>	.01974	.01314	-.02200
<i>SIZE</i>	20.897001	21.114658	20.954015
<i>CRI</i>	43.0686	41.3324	39.7242
<i>CHIGU</i>	3229.77	2767.03	94.44
<i>AGE</i>	43.82	41.23	—
<i>ACCOUNTANT</i>	3.04	4.21	3.12

**Table 6. The logistics regression analysis whether CFO enter board**

Variable	<i>B</i>	<i>Std. Error</i>	<i>Wald</i>	<i>df</i>	<i>Sig.</i>	<i>Exp(B)</i>
<i>Intercept</i>	-6.692	3.288	4.142	1	.042	
<i>CRI</i>	-.007	.007	.920	1	.338	.993
<i>BOARD</i>	-.078	.053	2.193	1	.139	.925
<i>SIZE</i>	-.515	.165	9.721	1	.002**	1.673
<i>CHGUQK</i>	.642	.300	6.103	1	.013**	.476
<i>ROA</i>	-.621	1.329	.219	1	.640	.537
<i>AGE</i>	.740	.011	14.112	1	.001**	.961
<i>ACCOUNTANT</i>	-0.052	.082	6.224	1	0.038**	0.487

Note: \*,\*\*and \*\*\* indicate respectively the two-tailed significance probability is 10%, 5%, 1%.

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