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Loss of control vs. risk reduction: decision factors for hiring non-family CFOs in family firms

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**Loss of Control vs. Risk Reduction –
Decision Factors for Hiring Non-Family CFOs in Family Firms**

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Loss of Control vs. Risk Reduction – Decision Factors for Hiring Non-Family CFOs in Family Firms

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Abstract

We examine decision factors of family firm owners for hiring a non-family Chief Financial Officer (CFO). We explore their perceptions towards external managers by analyzing how their goals relate to the employment of a non-family CFO. Furthermore, we analyze the consequences of hiring a non-family CFO on financial policies such as the use of strategic financial plans and initiatives to improve relationships with external capital providers. Our study is based on a survey of 237 small- and medium-sized privately-held German family firms in 2007. The results suggest that family firm owners are reluctant to hire non-family CFOs because of agency problems. They decide against an external CFO when their goal of independence and control is high. Furthermore, they do not seem to trust external managers to act in accordance to their goal of enterprise value growth. However, they seem to realize that non-family CFOs are likely to decrease financial risk through the provision of additional capabilities. Non-family CFOs are shown to influence financial policies and, thereby, to bring in value creating resources.

Keywords: Corporate governance, family firms, CFO, financial policy

JEL: G30, G32, L26

1 Introduction

In family firms, the managing responsibility is often at least partly handed to non-family managers. Business scholars have acknowledged that the integration of non-family managers in family firms can be seen both in the light of agency theory as well as the resource based view (Klein and Bell 2007). On the one hand, the presence of non-family managers may increase agency costs due to the separation of ownership and management. External managers may follow different objectives than the family and may therefore not act in accordance to family goals (Chua et al. 2003; Gallo and Vilaseca 1998). For instance, external managers are likely to have a shorter term view compared to family members who have the goal to hand over the company to the next generation. Furthermore, family members may be focused on dividend payouts to provide them with liquidity whereas an external manager may be inclined to reinvest cash into the company. This could then lead to conflicts between owner and manager in regard to the financial management of the company. On the other hand, external CFOs may bring in valuable external resources which the family can not provide from within their ranks. These resources could include industry-specific experience from working for other players in the same industry or function-specific experience, e.g. in the field of finance from working at financial institutions (Habbershon and Williams 1999; Klein and Bell 2007). Our aim is to increase the understanding of the role of non-family managers in family firms using both of these theoretical lenses.

Empirical evidence shows that the position of the Chief Financial Officer (CFO) is often the first key management position for which a non-family manager is hired (Filbeck and Lee 2000). A possible explanation is the finance-specific knowledge that is required for this position and the lack of a family member with the required background (Caselli and Di Giuli 2010; de Kok and Uhlaner 2001). The CFO has an important role in family firms because he is responsible to build a sustainable financial policy in order to safeguard the long term existence and independence of the family firm. Despite the relevance of external CFOs in family firms, business research has so far only directed limited attention to this specific role. Recent studies confirmed the importance of the relationship to external managers but the existent literature either focuses on the position of the CEO

(Blumentritt et al. 2007; Donaldson and Davis 1991; McConaughy 2000; Schmid and Zimmermann 2005; Tsai et al. 2009), on the non-executive board of directors (Bammens et al. 2008; Jaskiewicz and Klein 2007; Blumentritt 2006; Anderson and Reeb 2004; Corbetta and Salvato 2004) or do not differentiate between different positions of external managers (Brunninge et al. 2007; Lussier and Sonfield 2007; Chua et al. 2003). Only some initial studies exist which show a positive impact of non-family CFOs on operational performance (Caselli and Di Giuli 2010) and on the use of sophisticated financial products (Caselli et al. 2010; Filbeck and Lee 2000). Hence, we tackle a current research gap by analyzing specific decision factors for hiring non-family CFOs in family firms.

Based on a survey of 237 small- and medium-sized privately-held family firms in Germany in 2007, we analyze how goals of family firm owners relate to hiring a non-family CFO. In addition, we explore the association of non-family CFOs with financial policies such as the use of strategic financial plans and initiatives to improve relationships with external capital providers. We find that family firm owners are reluctant to decide for an external CFO if their goal of independence and control is high. In addition, they seem to have reservations whether external CFOs will act in line with their goal of enterprise value growth. However, they seem to realize that non-family CFOs can decrease financial risk through the provision of additional capabilities. Family firms with external CFOs are associated with the existence of a strategic financial plan, a larger number of bank relationships and a higher importance of initiatives to further improve the bank rating.

We make three important contributions with our study. First, we analyze the relationship between different goals of family firm owners and the decision to hire an external CFO. Thereby, we take account of the heterogeneity of family objectives and depict decision factors for and against employing a non-family CFO. Second, we show differences in financial policies between family firms with an internal and an external CFO which gives an indication on the consequences of hiring a non-family CFO. Third, our study offers valuable results both for theory and practice. We further disentangle the relationship between non-family managers and family business owners in the light of agency theory and the resource based view. Family firm owners get an insight on the relevant factors they should consider when hiring a non-family CFO. In particular, our research

shows that they should focus on establishing incentives to align their objective of enterprise value growth with the goal structure of the external manager. In turn, candidates for non-family CFOs can get a view on the underlying goals of family firm owners and how they impact the hiring decision.

2 Theoretical background and hypotheses

2.1 Theoretical perspectives

In order to analyze the relationship between non-family managers and family firm owners, two theoretical angles are particularly relevant: agency theory and the resource based view. According to agency theory, managers who are not owners of a company can be seen as agents who work for the company owners, the principals. The agent is assumed to maximize his own interest which is not necessarily in line with the objectives of the principal. Agency costs arise from initiatives which are targeted towards the alignment of interests of the agent to the principal (Jensen and Meckling 1976). Informational asymmetries between the agent and the principal make it difficult to ex-ante judge the level of anticipated agency problems (Akerlof 1970). In family-controlled businesses, agency costs are assumed to be low because ownership and management of the company both lie in the hands of the family leading to a natural alignment of interests (Uhlener et al. 2007). However, this requires symmetric altruism (Schulze et al. 2002) and stewardship behavior of the family managers (Davis et al. 1997). Due to the lack of family ties, non-family managers are not emotionally bound to the company and, hence, symmetric altruism and stewardship type of behavior is less likely (Chua et al. 2003). The external manager has an informational advantage about his capabilities, his motivation and his own interest. Therefore, the presence of non-family managers usually leads to an increase in agency costs. When a non-family CFO joins the family firm, it can be assumed that family-specific goals become less important in the financial management of the firm. The family loses part of their control over the company as the external CFO takes over responsibilities and may have different objectives than the family (Gallo and Vilaseca 1998).

The resource based view of the firm postulates that the competitive advantage of a company stems from the available resources to the firm (Wernerfelt 1984). In order for a resource to create a strategic advantage to the firm, it has to be valuable, rare, non-imitable and non-substitutable. The resource based view assumes that the resource profiles of companies remain heterogeneous due to the immobility of resources (Barney 1991). The interplay of family and business in a family firm leads to a unique bundle of material and immaterial resources which is referred to as the familiness (Habbershon and Williams 1999). The familiness can lead to strategic advantages (distinctive familiness) and disadvantages (constrictive familiness) depending on the individual setup of the business (Habbershon et al. 2003). For instance, family firms are often faced with a deficit in human resources. They tend to hire family members to higher ranked management positions even if they are not sufficiently qualified. In addition, non-family managers may view family firms as an unattractive option because they see limited potential to progress in the company against preferred family members (Sirmon and Hitt 2003).

Heterogeneity in the capabilities of the managers from different types of backgrounds and experiences can lead to well informed and balanced decision making. Hence, it can lead to competitive advantage if the family firm increases its human resources both in quality and heterogeneity through employing non-family managers (Castanias and Helfat 2001). In particular, financial knowledge is often scarce in family firms in case family members have not build any specialized experience outside of their family firm or outside their industry. The employment of an external CFO can therefore be a valuable addition to the human resources of a family firm.

The two theoretical angles, agency theory and the resource based view, exemplify the dichotomy for family firm owners in hiring external managers. On the one hand, external managers are likely to increase agency problems, imply a loss of control and lead to an increasing need for monitoring. On the other hand, external managers can be a valuable extension to the pool of human resources in a family firm. Our aim is to shed light on this dichotomy by analyzing relationships between goals of the family firm owners and the employment of non-family CFOs. In addition, we analyze whether family firms with an external CFO are associated with certain financial policies.

2.2 Goals of the family firm owner and the decision to hire a non-family CFO

The goals of the family firm owners give directions for the strategic management of the company and allow managers to be monitored against reaching the target. The interplay between the construct family and the construct business lead to complex goal structures (Holland and Boulton 1984; Tagiuri and Davis 1996; Reid et al. 1998). Our aim is to analyze whether these goals are relevant for the decision to hire a non-family CFO.

Family firms are characterized by a strong influence of the family on the strategic and often also the operational management of the firm. Privately-held family firms are usually less under pressure for short term performance compared to publicly-held companies which allows them to follow longer term strategies. Furthermore, family firm owners usually have lower disclosure requirements and often operate without any significant external influence (Kets de Vries 1993; Dreux 1990). The goal of independence and control is usually important for family firm owners to safeguard their influence in the company. The entrance of an external CFO can potentially threaten the goal of independence and control. The external CFO brings in an external perspective and influences financial decisions. Hence, we propose:

Hypothesis 1: The goal of independence and control is negatively associated with the employment of a non-family CFO.

Furthermore, the company can enable the family to be financially flexible. The family is often dependent on the company to provide them with liquidity as a high proportion of their capital is normally invested in the firm (Ward 1987; Neubauer and Lank 1998; Berent-Braun and Uhlaner 2010). Following agency theory, the employment of an external manager can lead to agency problems if the family goals are not in line with the goal of the external manager (Gallo and Vilaseca 1998; Klein and Bell 2007). It is possible that the objectives of the non-family CFO in terms of cash flow management differ from the goals of the family as the family is focused on receiving dividends whereas the external manager aims to limit dividends in order to grow the company in the shorter term. The family is

likely to be less able to use the company as a flexible source of liquidity if a CFO controls the financial management. Therefore, we hypothesize:

Hypothesis 2: The goal of financial flexibility is negatively associated with the employment of a non-family CFO.

Another important goal of the family is low financial risk because a large share of their personal wealth is usually bound in the company (Ang 1992; Haynes et al. 1999). From a theoretical point of view, two opposing arguments can be drawn on the decision to hire a non-family CFO in this context. On the one hand, the agency costs usually increase with the employment of an external manager. Family members are more likely to follow symmetric altruism and to follow a stewardship type of behavior (Chua et al. 2003). Hence, this would lead to a decision against an external CFO to lower the financial risk of the family. On the other hand, a diverse management team with managers of different backgrounds and experiences can bring in valuable resources to the company (Sirmon and Hitt 2003; Wiersema and Bantel 1992). The employment of a non-family CFO can lead to a reduction of the dependency of the company on the family which can decrease the overall financial risk. We thus formulate two opposing hypotheses:

Hypothesis 3a: The goal of low financial risk is positively associated with the employment of a non-family CFO.

Hypothesis 3b: The goal of low financial risk is negatively associated with the employment of a non-family CFO.

Family succession is usually a highly ranked objective of family firm owners. The actual succession process from one generation to the next is an important challenge for family firms (Le Breton-Miller et al. 2004). External parties like external non-executive board members or consultants can bring in their experience and a neutral opinion on sensitive issues (Gersick et al. 1997). However, many family firms do not have non-executive board members and shy away from consultants. In this case, a non-family manager can be a stabilizing factor in the critical phase of succession by moderating between the generations. Furthermore, it can be helpful to have continuity in the important position of the CFO throughout the succession process. This can be particularly relevant if it is foreseeable that it will not be possible to have an overlap of family managers from different generations working jointly in the family firm. The age difference

between the family members can for instance be too large or there could be a generation without an appropriate successor. Hence, we hypothesize:

Hypothesis 4: The goal of family succession is positively associated with the employment of a non-family CFO.

Another important goal of family firm owners is the goal of enterprise value growth which can be relevant for the decision to hire an external CFO. Non-family CFOs are only bound to the company temporarily through their employment and, hence, they are probably focused on a shorter time frame in their financial decisions (Daily and Dollinger 1992). In contrast, family members have the objective to keep the control over the company in family hands in the long term and, in addition, they are emotionally attached to the business (James 1999). Therefore, a family CFO is likely to initiate longer term financing and investing strategies to foster a sustainable company growth (Miller and Le Breton-Miller 2006). Following agency theory, a non-family CFO will show less engagement for long term enterprise value growth and, hence, family firm owners would be reluctant to hire an external CFO. However, empirical evidence shows that non-family CFOs can also have a positive influence on the development of the company. It was shown that family firms with an external CFO show a higher growth in operational performance compared to other family firms (Caselli and Di Giuli 2010). This can partly be explained by the special knowledge of non-family CFOs in the field of finance. Even though family members often also have expertise in financial management, it may be that for family CFOs it was not only their abilities which led to their employment but also their family status. Family firm owners with a strong focus on the goal of enterprise value growth may realize that an external CFO may bring in valuable additional resources required for company growth. Due to these contradicting arguments, we formulate the two opposing hypotheses:

Hypothesis 5a: The goal of enterprise value growth is positively associated with the employment of a non-family CFO.

Hypothesis 5b: The goal of enterprise value growth is negatively associated with the employment of a non-family CFO.

For family firm owners, it is often an important objective to take over social responsibility in their community (Tagiuri and Davis 1992; Westhead 2003;

Uhlener et al. 2004). This includes social activities which go beyond the initiatives required by law. Recent studies have shown that family firm owners show higher commitment towards their employees compared to non-family firms (Dyer and Whetten 2006; Stavrou et al. 2007). Family firm owners often stress that it is important for them to provide their work force with long term employment and to support them through ensuring a pleasant work environment. This can be explained with the long term orientation of family firm owners and the importance of a good reputation of the family in the community, particularly in case the company name entails the family name (Dyer and Whetten 2006). An external CFO who is not emotionally bound to the company may not rank the goal of social responsibility as high as the family members and this may manifest itself in the initiated financing and investing strategies. Family firm owners who highly rank the goal of social responsibility may therefore be reluctant to hire a non-family CFO. Hence, we propose:

Hypothesis 6: The goal of social responsibility is negatively associated with the employment of a non-family CFO.

2.3 Non-family CFO and financial policy

In addition to the influence of goals of the family on the decision to hire an external CFO, we also investigate relationships between the employment of a non-family CFO and the financial policy in the firm. We have to acknowledge that the owners of the family firm also have an influence on the financial policy, but we assume an external CFO to have a substantial impact on it. However, we have to take account of possible endogeneity problems because only family firm owners who want to follow a certain financial policy may decide to hire an external CFO. But setting aside this limitation of our study, we believe to analyze relevant relationships between the existence of an external CFO and the financial management in a family firm.

Business scholars have acknowledged the importance of strategic planning in family firms because it structures the long term vision of the family for the company and the succession process (Ward 1988; Carlock and Ward 2001). Strategic planning in family firms is challenging as the manifold interests of the

family have to be taken into consideration (Poutziouris 2001). Empirical studies show a positive impact of institutionalized planning processes in family firms on the company development (Upton et al. 2001; Schulze et al. 2001). Despite the importance of strategic planning, many family firm owners decide against setting up formalized planning processes. Particularly privately-held family firms do not have to justify their decisions to external shareholders due to the concentration of ownership in the hands of the family. Therefore, many processes in family firms are characterized by low formality, a flat hierarchy and high flexibility (Dailey et al. 1977). The amount of strategic financial planning gives an insight in the financial policies of family firms as it can be seen as an indicator for the level of professionalization. The lack of a strategic financial plan suggests an unstructured financial management which is focused on short term operations (Rue and Ibrahim 1996). If a non-family CFO is employed, a strategic financial plan may be important in order to set common goals between him and the family members on the financial policies going forward. This may then reduce agency costs of hiring an external manager as the financial plan can be used as a monitoring instrument. In contrast, a family CFO is likely to shy away from the transparency that a strategic financial plan requires (Mintzberg 1994). In addition, a non-family CFO may bring in his outside experience to set up a formalized process of strategic financial planning. Hence, we propose:

Hypothesis 7: The employment of a non-family CFO is positively associated with the existence of a strategic financial plan.

Privately-held family firms in Germany focus their external financing sources usually on debt financing and they often concentrate their business relations on a single bank, the so called “Hausbank” (Allen and Gale 1995). Family firms highly value the personal character and the continuity of such a relationship and banks get valuable information about the companies which can be important for future refinancing decisions (Boot 2000). But regulatory changes such as the Basel II capital requirement directive require a higher amount of standardized processes which reduce the personal character of the relationship between companies and banks (Harhoff and Körting 1998). However, it can be expected that family firm owners still try to focus their relationships on a small number of banks. In contrast, non-family CFOs are likely to bring in an unbiased external view which may lead to the diversification of bank relationships. External CFOs may be more

inclined to professionalize the relationship to debt providers and to pro-actively manage these relationships in order to get attractive financing conditions (Filbeck and Lee 2000; Caselli and Di Giuli 2010). This could then lead to a higher number of bank relationships, a better bank rating and a higher importance of initiatives to improve the bank rating. Therefore, we hypothesize:

Hypothesis 8: The employment of a non-family CFO is positively associated with the number of bank relationships.

Hypothesis 9: The employment of a non-family CFO is positively associated with the current bank rating.

Hypothesis 10: The employment of a non-family CFO is positively associated with the importance of initiatives to improve the bank rating.

3 Sample description and methodology

Our study is based on a survey of family firm owners in German privately-held companies. The questionnaire included 22 questions on the goals of the family, the use of different financial instruments, the members of the management board, the members of the advisory board and general statistics of the firm. We wanted to capture the aggregated objectives of all family members so we specifically linked the question on the family goals to overall family goals rather than personal goals. In order to detect issues with filling out the questionnaire, we conducted a pre-test with six family firm owners prior to sending it out (Bradburn et al. 2004).

Using the Hoppenstedt database and the member list of AlphaZirkel, an association of family firms in Germany, we collected a list of 1,818 German family firms. We sent out the questionnaire to all family firm owners in mid 2007 and followed up four weeks later via telephone to increase the response rate. In terms of representativeness, our sample already showed high similarities with the large samples used in other studies, e.g. in terms of size, age and industry (IfM Bonn 2007; Klein 2004). But we found Bavaria to be overly represented in our initial sample and, hence, we concentrated our follow-up on other regions in Germany to prevent a regional bias.

In total, we received 247 questionnaires which represent a response rate of 14%. However, we were not able to use all of them as we wanted to ensure to have a sample of firms in which the family firm owner has a significant influence on company policies. Therefore, we included only companies in which the family either hold 100% ownership and/or had majority control over the management or supervisory board (Klein 2000). We also excluded publicly listed family firms and companies from the financial sector. This led to a final sample of 237 questionnaires which represents a response rate of 13%.

Insert Table 1 about here

Table 1 gives an overview of the variables we used in our analysis. In the first part of our study, we use the existence of a non-family CFO as dependent variable. It is a binary variable with one representing the existence of a non-family CFO and zero representing the non-existence. As independent variables, we use variables representing goals of the family firm owners which include the goal of independence and control, the goal of financial flexibility, the goal of low financial risk, the goal of family succession, the goal of enterprise value growth and the goal of social responsibility. Based on a nine point Likert scale, we surveyed the importance of these goals for the family (1=highly irrelevant, 9=highly relevant). We used this broad scale to detect nuances and higher variances in the replies (Alwin 1997).

In the second part, the existence of a non-family CFO was used as an independent variable. We included four different dependent variables on financial policies in the family firm included in our survey. We use the existence of a strategic financial plan as binary dependent variable with one representing the existence of a strategic financial plan and zero representing the non-existence. The number of bank relationships is included as metric dependent variable. The current bank rating is another dependent variable and is represented on an eight point Likert scale (1=C, 2=CC, 3=CCC, 4=B, 5=BB, 6=BBB, 7=A, 8=AA). Finally, we used the importance of initiatives to improve the bank rating on a seven point Likert scale (1=highly unimportant, 7=highly important) as dependent variable.

In both parts of our study, we used the same set of control variables to take account of potential differences due to company size and industry. With increasing company size family firms are likely to be more dependent on external

managers which would in turn influence their decision to hire an external CFO (Chua et al. 2003). Furthermore, the size of a company is also likely to influence the financial policy. We use four control variables as indicators for potential size effects: a dummy variable for founding generation family firms, the number of family owners, the revenue in the last financial year and the age of the company. In addition, we expect that the level of financial distress may have an influence both on the decision to employ a non-family CFO and financial policies in the family firm. The level of financial distress was surveyed in the questionnaire on a seven point Likert scale (1=very little, 7=very high). Furthermore, we want to exclude industry effects and include binary industry variables for manufacturing and service industries. In the second part of our study, we included an additional control variable to take account of the years of experience of the CFO. It is a metric variable which represents the number of years of experience in finance positions prior to his appointment as CFO as this may be a relevant driver for financial policies. Table 2 shows descriptive statistics for the variables we used in our analysis.

Insert Table 2 about here

In the first part of our analysis, we use binary logistic regressions to analyze relationships between the goals of the family firm owner and the existence of a non-family CFO (Model 1). For the second part of the analysis, we use binary logistic regressions to test the relationship between the existence of a non-family CFO and the existence of a strategic financial plan (Model 2a). For the other dependent variables including the number of bank relationships (Model 3a), the current bank rating (Model 4a) and the initiatives to improve the bank rating (Model 5a), we use OLS regression analysis. Furthermore, we run a separate set of regressions on the financial policy indicators also including the goals of the family firm as additional control variables (Model 2b, Model 3b, Model 4b and Model 5b). It is likely that the family goals influence the financial policy in a family firm and an external CFO may act as mediator for these family goals.

Our models account for heteroskedasticity by estimating Huber-White robust standard errors (White 1980). For the binary logistic regressions, we also report the marginal effects in addition to the coefficients in order to be able to interpret the magnitude of the relationships. The marginal effects at the average were

estimated by replacing all other independent variables with their sample mean. We also conducted probit regressions to test the robustness and the results remained the same with only minor differences in some of the significance levels.

We also tested for multicollinearity in our data and analyzed binary correlations based on Kendall's tau because many of our variables are dichotomous or categorical. Table 3 and Table 4 report the correlation matrix for the first and second part of our analysis. It reveals high correlations only for the variable for founding generation family firms with the variable for age and between industry variables. In addition, we also checked variance inflation factors as indicator for multicollinearity (Studenmund 2006) in our models. The maximum variance inflation factors were lower than two in all our models so we assume to not have multicollinearity problems.

Insert Table 3 & 4 about here

We tested our data for an early versus late respondent bias as it can be expected that late respondents are similar to family firms who did not respond at all. Hence, we thereby check for a non response bias in our data (Oppenheim 1966). Based on a discriminant analysis, we compared the respondents prior to the follow-up with the respondents thereafter. We did not find significant differences between the two groups based on a difference in means analysis. Finally, we tested for extreme values and decided to include the natural logarithm for the variable revenue in order to prevent a distortion of our results due to extreme values in this variable.

4 Empirical results

4.1 Goals of the family firm owner and the decision to hire a non-family CFO

Table 5 presents the results of our binary logistic regression with the existence of a non-family CFO as dependent variable. Overall, Model 1 is significant at the 5% level and has a McFadden's R^2 of 0.129. We therefore assume to be able to show relevant drivers for the decision to employ a non-family CFO in family firms.

Insert Table 5 about here

The family-specific goal of independence and control is negatively associated with the employment of a non-family CFO (significant at the 10% level) and we can support Hypothesis 1. Family firm owners with a focus on having full control over the firm shy away from hiring an external CFO. In terms of the magnitude, the marginal effect shows that this relationship is relatively weak which is surprising given the importance of keeping control for family firm owners. The probability of hiring an external CFO decreases by 3.7% in case the importance of the goal of independence and control increases by one point on the nine point Likert scale. The coefficient of the variable for the goal of financial flexibility points in the anticipated negative direction, but is not significant. We can therefore not support Hypothesis 2 that the goal of financial flexibility is negatively associated with the existence of an external CFO.

The goal of low financial risk has a significantly positive influence on the employment of a non-family CFO at the 10% level and we can support Hypothesis 3a (reject Hypothesis 3b). It seems that family firm owners realize that an external CFO offers additional resources which can reduce their financial risk. With marginal effects of 4.4%, this relationship is slightly stronger than the influence of the goal of independence and control. For the goal of family succession we did not find a significant relationship. The coefficient points in the expected positive direction, but we can not support Hypothesis 4.

The goal of enterprise value growth is negatively associated with the employment of an external CFO. This relationship is significant at the 5% level and in terms of magnitude it is the strongest. A one point change in the importance of the goal of enterprise value growth on a nine point Likert scale decreases the likelihood of a non-family CFO by 6.0%. Family firm owners seem to distrust external managers to have the same perspective on long term company growth. We find support for Hypothesis 5b and reject Hypothesis 5a. For the goal of social responsibility, we did not find any significant relationship and we can not support Hypothesis 6. But the coefficient points in the anticipated negative direction.

For the control variables, only the two variables founding generation family firm and age show significant relationships at the 10% and 1% level respectively. Both of these variables show the same result that young family firms are less likely to employ an external CFO. For founding generation family firms, this relationship

is particularly strong. The likelihood of employing an external CFO is 19% lower for founding generation family firms. In this early stage of company development, the family firm owner is less dependent on external managers.

4.2 Non-family CFO and financial policy

The results of our analysis on relationships between the employment of non-family CFOs and the financial policy are shown in Table 6. In all our models, the existence of an external CFO has a significant impact on our dependent variables. In Model 2a, based on a binary logistic regression, we show that a non-family CFO is positively associated with the existence of a strategic financial plan. The relationship is significant at the 10% level and we can support Hypothesis 7. The likelihood of having a strategic financial plan is 9% higher if a non-family CFO is present in the company. The control variable number of family owners has a significant positive impact on the existence of a strategic financial plan. With an increasing number of family owners, it becomes more relevant to establish a formalized plan on future financing and investing strategies as informal decision making gets more difficult. With an increasing number of family owners, agency problems within the family are likely to become more relevant as the individual identification with the firm may decrease and stewardship type of behavior may be less common. A strategic financial plan can then act as control tool for the family.

Insert Table 6 about here

Regarding the relation to external debt providers, a non-family CFO is shown to have a significant impact on all three dependent variables. The employment of an external CFO is positively associated with the number of bank relationships (significant at the 5% level, Model 3a). A non-family CFO is inclined to diversify the relations to external capital providers and we can support Hypothesis 8. In addition, family firms with an external CFO put more effort into improving their bank rating (significant at the 10% level, Model 5a), so we can support Hypothesis 10. However, our results show that family firms with a non-family CFO have a lower current bank rating (significant at the 5% level, Model 4a), so we have to reject Hypothesis 9. It may be that family firms with a lower current

bank rating turn to an external CFO in order to help to improve the rating in the future. This may also stem from financial distress in the company. As can be seen from the control variable for the level of financial distress, a higher level of financial distress is associated with a lower bank rating (significant at the 5% level) and a higher importance of initiatives to improve the bank rating (significant at the 1% level).

Insert Table 7 about here

In additional regressions reported in Table 7, we tested whether the goals of the family firm owner from the first part of our analysis have an additional impact on financial policies. It could be argued that an external CFO acts primarily as a mediator for the goals of the family. We therefore included the goals of the family as additional control variables. The results remained the same with minor differences in some of the significance levels which confirms the robustness of our results. In two cases, we found a significant relationship between the goals of the family firm owner and financial policies. The goal of enterprise value growth is positively associated with the existence of a strategic financial plan (significant at the 10% level, Model 3b) and the goal of low financial risk is positively associated with the importance to improve the current bank rating (significant at the 1% level, Model 5b). The impact of the goal of low financial risk is strong and, hence, seems to overshadow the impact of the non-family CFO. The impact of the external CFO on the importance to improve the current bank rating is not significant anymore in Model 5b. For the two cases of significant influences of family goals on the financial policy, we tested whether the external CFO mediates the influence of the family goals. Based on the Baron/Kenny criteria, we were not able to support a mediating role of a non-family CFO for the goal of enterprise value growth and the goal of low financial risk (Baron and Kenny 1986). In addition, Sobel Goodman mediation tests which are applicable to OLS regressions could not confirm a mediating role of non-family CFOs for the goal of low financial risk (Wood et al. 2008). Our results therefore show that the influence of an external CFO on financial policies is not directly linked to the goals of the family.

5 Conclusion

This paper analyzes the decision to hire an external CFO in privately-held family firms. The role of external managers in family firms can be seen from the angle of agency theory as well as the resource based view. Agency theory stresses potential conflicts that can arise by employing an external manager who is not owner of the company as he is likely to have different objectives than the family firm owner (Chua et al. 2003; Gallo and Vilaseca 1998). Following the resource based view, hiring a non-family CFO may also bring in valuable additional human resources the family can not supply from within their ranks (Habbershon and Williams 1999; Klein and Bell 2007). Based on a survey of 237 German privately-held family firms in 2007, we set out to shed further light on why family firms decide or not decide to employ an external CFO.

In the first part of our study, we analyzed whether goals of family firm owners are related to the employment of an external CFO. We show that the goal of independence and control is hindering family firm owners from employing an external CFO. They realize that a non-family member in this important position will decrease their influence on financial decisions. At the same time, they do not seem to trust non-family CFOs to act in line with their goal of enterprise value growth. Family firm owners should hence focus on trying to establish incentives to align their own interest of a long term company development to the objectives of external managers. We also find that family firm owners with a focus on lowering their financial risk are going to turn to external managers as CFOs. This is an indication that despite the loss of control, family firm owners also see that a non-family CFO can reduce their risk by adding valuable additional resources to the firm.

In the second part of our study, we focused on relationships between the employment of an external CFO and financial policies in the family firm. We showed that family firms with a non-family CFO are more likely to have a strategic financial plan, a higher number of bank relationships and put more importance on initiatives to improve their bank rating. This confirms earlier studies that external CFOs seem to be able to professionalize financial management in family firms. However, we also show that family firms with non-family CFOs on average have a lower bank rating. It is likely that family firms in

financial distress turn to external CFOs to help them improve their finances. Family firm owners may then be willing to give up part of their control.

Implications both for family firm owners and for potential recruits for a position as external CFO in family firms can be drawn from our analysis. First, family firm owners should realize that by giving away part of the control over their company, they can also gain additional valuable input and potentially lower their financial risk through the employment of a non-family CFO. They should however put effort into setting up incentives for the external manager to act in accordance to their goal of enterprise value growth, e.g. through share option schemes. Future research is required to analyze appropriate incentive structures for non-family CFOs. Candidates for the role of an external CFO can use our results to anticipate relevant decision factors for the family in the recruiting process.

Our study has some limitations. First, even though our sample does not seem to be different compared to larger samples of German family firms, we can not disregard the problem of survivorship bias in our survey based study. We are not able to include insolvent family firms and it would be interesting to further analyze the role of external CFOs in failed family firms. Second, our study is limited by potential endogeneity problems. It is unlikely that a non-family CFO has a significant impact on the overall goals of the family analyzed in the first part of our study. But regarding the financial policy, it could be that family firm owners select an external CFO if they want to follow a certain financial policy. There could also be additional relationships we were not able to explore in our analysis. For instance, an external CEO could have a substantial impact on the decision to hire an external CFO and on the financial policies. Further studies should analyze the relationships between different external managers in family firms to shed light on this issue.

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Table 1: Definition of variables

Variables	Definition
Dependent variables:	
Non-family CFO	Dummy variable: it equals 1 for family firms with a non-family member as CFO, otherwise it equals 0
Existence of a strategic financial plan	Dummy variable: it equals 1 for family firms which have a strategic financial plan, otherwise it equals 0
Number of bank relationships	Metric variable: it represents the number of bank relationships of the family firm
Current bank rating	Metric variable: it represents the bank rating on an eight point scale (1=C, 2=CC, 3=CCC, 4=B, 5=BB, 6=BBB, 7=A, 8=AA)
Initiatives to improve bank rating	Metric variable: it represents the importance of initiatives to improve the bank rating on a seven point Likert scale (1=highly unimportant, 7=highly important)
Independent variables:	
Goal of independence and control	Metric variable: it represents the importance of the goal of independence and control for the family on a nine point Likert scale (1=highly irrelevant, 9=highly relevant)
Goal of financial flexibility	Metric variable: it represents the importance of the goal of financial security for the family on a nine point Likert scale (1=highly irrelevant, 9=highly relevant)
Goal of low financial risk	Metric variable: it represents the importance of the goal of low risk for the family on a nine point Likert scale (1=highly irrelevant, 9=highly relevant)
Goal of family succession	Metric variable: it represents the importance of the goal of family succession on a nine point Likert scale (1=highly irrelevant, 9=highly relevant)
Goal of enterprise value growth	Metric variable: it represents the importance of the goal of enterprise value growth for the family on a nine point Likert scale (1=highly irrelevant, 9=highly relevant)
Goal of social responsibility	Metric variable: it represents the importance of the goal of social responsibility for the family on a nine point Likert scale (1=highly irrelevant, 9=highly relevant)
Control variables:	
Founding generation family firm	Dummy variable: it equals 1 for founding generation family firms, otherwise it equals 0
Number of family owners	Metric variable: it represents the number of family owners in the family firm
Revenue in the last financial year	Natural logarithm of the revenue in the last financial year
Age	Metric variable: number of years since the founding date of the family firm
Level of financial distress	Metric variable: it represents the level of financial distress in the family firm on a seven point Likert scale (1=very little, 7=very high)
Manufacturing industries	Dummy variable: it equals 1 for family firms active in manufacturing industries, otherwise it equals 0
Service industries	Dummy variable: it equals 1 for family firms active in service industries, otherwise it equals 0
Retail/Wholesale	Dummy variable: it equals 1 for family firms active in retail/wholesale, otherwise it equals 0
Years of experience of CFO	Metric variable: it represents the number of years of experience of the CFO in finance prior to his appointment

Table 2: Descriptive statistics

This table reports means, medians, standard deviations, minima and maxima for the variables used in our regression analysis. The sample is based on questionnaires of 237 German family firms from 2007. Differences in sample size are due to missing values.

Variables	N	Mean	Median	S.D.	Min.	Max.
Dependent variables:						
Non-family CFO	236	0.28	0.00	0.45	0.00	1.00
Existence of a strategic financial plan	227	0.83	1.00	0.37	0.00	1.00
Number of bank relationships	232	4.29	4.00	1.72	1.00	7.00
Current bank rating	164	6.37	6.00	1.00	2.00	8.00
Initiatives to improve bank rating	225	4.73	5.00	1.39	1.00	7.00
Independent variables:						
Goal of independence and control	227	7.33	8.00	1.93	1.00	9.00
Goal of financial flexibility	235	7.79	8.00	0.92	4.00	9.00
Goal of low financial risk	236	6.41	7.00	1.49	2.00	9.00
Goal of family succession	232	6.38	7.00	2.24	1.00	9.00
Goal of enterprise value growth	236	7.03	7.00	1.26	2.00	9.00
Goal of social responsibility	237	6.65	7.00	1.39	2.00	9.00
Control variables:						
Founding generation family firm	232	0.28	0.00	0.45	0.00	1.00
Number of family owners	234	3.71	2.00	7.52	1.00	100.00
Revenue in the last financial year	231	4.17	4.17	1.40	0.00	8.85
Age	235	69.91	59.00	51.90	4.00	410.00
Level of financial distress	225	2.51	2.00	1.64	1.00	7.00
Manufacturing industries	237	0.66	1.00	0.48	0.00	1.00
Service industries	237	0.18	0.00	0.38	0.00	1.00
Retail/Wholesale	237	0.16	0.00	0.37	0.00	1.00
Years of experience of CFO	210	11.63	10.00	9.15	0.00	45.00

Table 3: Correlation matrix: Non-family CFO

This table reports correlations for the variables used in our logistic regression analysis for Model 1 with the dummy variable non-family CFO as dependent variable. The sample is based on questionnaires of 237 German family firms from 2007. The correlation coefficients are based on Kendall's tau. * significant at the 5% level.

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1 Non-family CFO	1.000														
2 Goal of independence and control	-0.048	1.000													
3 Goal of financial flexibility	-0.054	0.134 *	1.000												
4 Goal of low financial risk	0.066	0.049	0.166 *	1.000											
5 Goal of family succession	0.087	0.320 *	0.016	0.086	1.000										
6 Goal of enterprise value growth	-0.108	0.136 *	0.202 *	0.084	0.153 *	1.000									
7 Goal of social responsibility	-0.020	0.196 *	0.252 *	0.284 *	0.057	0.187 *	1.000								
8 Founding generation family firm	-0.069	-0.106	0.151 *	-0.002	-0.237 *	0.054	0.121	1.000							
9 Number of family owners	0.130 *	0.127 *	-0.100	0.040	0.202 *	-0.081	0.028	-0.382 *	1.000						
10 Revenue in the last financial year	0.076	0.209 *	-0.043	-0.158 *	0.193 *	0.125 *	-0.059	-0.257 *	0.208 *	1.000					
11 Age	0.162 *	0.136 *	-0.049	-0.042	0.226 *	0.000	-0.065	-0.573 *	0.319 *	0.306 *	1.000				
12 Level of financial distress	-0.059	-0.223 *	-0.090	-0.077	0.002	-0.002	-0.074	0.009	-0.081	-0.139 *	-0.075	1.000			
13 Manufacturing industries	0.012	0.060	-0.029	-0.063	0.044	0.008	0.026	-0.172 *	0.062	0.147 *	0.108	0.065	1.000		
14 Service industries	-0.038	-0.042	0.020	0.077	-0.018	-0.051	0.030	0.229 *	-0.005	-0.188 *	-0.136 *	0.033	-0.628 *	1.000	
15 Retail/Wholesale	0.023	-0.034	0.017	0.003	-0.038	0.040	-0.062	-0.013	-0.073	0.004	0.000	-0.114	-0.628 *	-0.211 *	1.000

Table 4: Correlation matrix: Financial policy

This table reports correlations for the variables used in our regression analysis for Model 2a, 3a, 4a and 5a with different indicators of the financial policy as dependent variables. The sample is based on questionnaires of 237 German family firms from 2007. The correlation coefficients are based on Kendall's tau. * significant at the 5% level.

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 Existence of a strategic financial plan	1.000													
2 Number of bank relationships	0.083	1.000												
3 Current bank rating	0.028	-0.186 *	1.000											
4 Initiatives to improve bank rating	0.125 *	0.119 *	0.043	1.000										
5 Non-family CFO	0.124	0.106	-0.178 *	0.009	1.000									
6 Years of experience of CFO	0.009	0.055	-0.017	0.070	-0.001	1.000								
7 Founding generation family firm	0.059	-0.113	0.025	0.032	-0.043	0.034	1.000							
8 Number of family owners	0.132 *	0.052	0.065	-0.068	0.093	0.057	-0.338 *	1.000						
9 Revenue in the last financial year	0.081	0.383 *	-0.057	0.006	0.052	0.066	-0.241 *	0.196 *	1.000					
10 Age	0.017	0.159 *	-0.057	-0.048	0.133 *	-0.068	-0.584 *	0.286 *	0.273 *	1.000				
11 Level of financial distress	0.003	0.020	-0.141 *	0.240 *	-0.091	0.052	-0.006	-0.075	-0.133 *	-0.059	1.000			
12 Manufacturing industries	0.048	0.023	-0.012	-0.020	0.013	0.054	-0.247 *	0.095	0.130 *	0.164 *	0.057	1.000		
13 Service industries	0.027	-0.080	0.102	0.054	-0.043	-0.054	0.249 *	-0.049	-0.123 *	-0.169 *	0.037	-0.644 *	1.000	
14 Retail/Wholesale	-0.090	0.053	-0.084	-0.030	0.028	-0.014	0.061	-0.072	-0.039	-0.036	-0.112	-0.616 *	-0.206 *	1.000

Table 5: Regression results: Non-family CFO and family goals

This table presents the results of binary logistic regressions. The dependent variable is a dummy variable which is equal to 1 for family firms which employ a non-family CFO and 0 otherwise. The sample is based on questionnaires of 195 German family firms from 2007. Coefficients are adjusted for heteroskedasticity. Marginal effects represent marginal effects at the average, i.e. they are derived by replacing all other explanatory variables with their sample mean. * significant at the 10% level, ** significant at the 5% level, *** significant at the 1% level.

Variables	Model 1	
	Coefficient	Marginal effect
Dependent variable: Non-family CFO		
Independent variables: Family-specific goals		
Goal of independence and control	-0.221 *	-0.037 **
Goal of financial flexibility	-0.081	-0.014
Goal of low financial risk	0.259 *	0.044 *
Goal of family succession	0.144	0.024
Goal of enterprise value growth	-0.359 **	-0.060 **
Goal of social responsibility	-0.011	-0.002
Control variables:		
Founding generation family firm	1.077 *	0.194 *
Number of family owners	0.019	0.003
Revenue in the last financial year	0.097	0.016
Age	0.018 ***	0.003 ***
Level of financial distress	-0.041	-0.007
Manufacturing industries	0.003	0.000
Service industries	-0.342	-0.055
N	195	195
McFadden's R ²	0.129	0.129
Chi ²	25.219	25.219
Log. Likelihood	-99.364 **	-99.364 **
AIC	226.728	224.728

Table 6: Regression results: Financial policy and non-family CFO

This table presents the results of OLS and binary logistic regressions. The dependent variables are indicators of the financial policy and include the existence of a long term strategic plan (Model 2a), the number of bank relationships (Model 3a), the current bank rating (Model 4a) and the importance of initiatives to improve the bank rating (Model 5a). The existence of a non-family CFO is the independent variable and different indicators for the size, industry and the level of financial distress are used as control variables. The sample is based on questionnaires of 185 German family firms from 2007. Differences in sample size are due to missing values. Coefficients are adjusted for heteroskedasticity. Marginal effects represent marginal effects at the average, i.e. they are derived by replacing all other explanatory variables with their sample mean. * significant at the 10% level, ** significant at the 5% level, *** significant at the 1% level.

	Model 2a Logit		Model 3a OLS	Model 4a OLS	Model 5a OLS
	Coefficient	Marginal effect	Coefficient	Coefficient	Coefficient
Dependent variable:	Existence of a strategic financial plan		Number of bank relationships	Current bank rating	Initiatives to improve bank rating
Independent variable:					
Non-family CFO	0.966 *	0.091 **	0.462 **	-0.394 **	0.396 *
Control variables:					
Years of experience of CFO	0.006	0.001	-0.002	-0.011	0.014
Founding generation family firm	0.284	0.029	0.022	-0.009	-0.127
Number of family owners	0.318 *	0.034 *	-0.003	0.014 ***	0.003
Revenue in the last financial year	0.241	0.026	0.633 ***	-0.078	0.130 **
Age	-0.007	-0.001	0.002	0.000	-0.005 **
Level of financial distress	0.214	0.023	0.125 **	-0.167 **	0.240 ***
Manufacturing industries	0.697	0.079	-0.222	0.186	0.076
Service industries	0.771	0.071	-0.346	0.549 **	0.054
N	185	185	185	135	182
R ²			0.332	0.176	0.136
McFadden's R ²	0.105	0.105			
Log. Likelihood	-65.604 *	-65.604 *	-316.760 ***	-170.526 ***	-295.616 ***

Table 7: Regression results: Financial policy, non-family CFO and family goals

This table presents the results of OLS and binary logistic regressions. The dependent variables are indicators of the financial policy and include the existence of a long term strategic plan (Model 2b), the number of bank relationships (Model 3b), the current bank rating (Model 4b) and the importance of initiatives to improve the bank rating (Model 5b). The existence of a non-family CFO is the independent variable and family goals as well as different indicators for the size, industry and the level of financial distress are used as control variables. The sample is based on questionnaires of 173 German family firms from 2007. Differences in sample size are due to missing values. Coefficients are adjusted for heteroskedasticity. Marginal effects represent marginal effects at the average, i.e. they are derived by replacing all other explanatory variables with their sample mean. * significant at the 10% level, ** significant at the 5% level, *** significant at the 1% level.

	Model 2b Logit		Model 3b OLS	Model 4b OLS	Model 5b OLS
	Coefficient	Marginal effect	Coefficient	Coefficient	Coefficient
Dependent variable:	Existence of a strategic financial plan		Number of bank relationships	Current bank rating	Initiatives to improve bank rating
Independent variable:					
Non-family CFO	0.943 *	0.087 *	0.436 *	-0.537 ***	0.277
Control variables:					
Goal of independence and control	-0.024	-0.003	-0.042	-0.060	-0.093
Goal of financial flexibility	0.376	0.039	-0.088	-0.019	0.077
Goal of low financial risk	-0.016	-0.002	-0.038	0.037	0.177 ***
Goal of family succession	0.025	0.003	0.003	-0.017	0.061
Goal of enterprise value growth	0.311 *	0.032 *	0.042	-0.072	0.050
Goal of social responsibility	0.221	0.023	-0.089	-0.005	0.010
Years of experience of CFO	-0.015	-0.002	0.002	-0.009	0.010
Founding generation family firm	-0.239	-0.025	0.079	0.167	-0.072
Number of family owners	0.387 **	0.040 **	-0.002	0.015 ***	0.001
Revenue in the last financial year	0.183	0.019	0.581 ***	-0.044	0.163 **
Age	-0.011	-0.001	0.002	0.002	-0.004 *
Level of financial distress	0.279	0.029	0.115 *	-0.152 **	0.248 ***
Manufacturing industries	0.778	0.086	-0.258	0.100	0.132
Service industries	0.888	0.078	-0.398	0.433	0.122
N	172	172	173	126	170
R ²			0.324	0.223	0.214
McFadden's R ²	0.157	0.157			
Log. Likelihood	-58.625 **	-58.625 **	-296.835 ***	-155.454 ***	-266.372 ***