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The Best CEO-CFO Team for M&As

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Buyouts engineered by optimistic CEOs and pessimistic CFOs have the best odds of success.

As the US-China trade war drags on, sirens are going off on sales, earnings and growth forecasts around the world. But one aspect of corporate activity is bucking the gloom: mergers and acquisitions (M&As). Global appetite for M&As is at a **10-year peak**, fuelled by years of **sustained economic growth** and low cost of debt. Announced transaction volumes surged to US$4.1 trillion in 2018, the third highest ever. In Singapore, 14 companies were bought out or privatised in the first half of 2019, more than the 2018 full-year tally.

The froth belies the fact that M&As, which can pave a fast track to future growth if done right, are risky propositions with a failure rate of 80 percent. Nonetheless, investors and analysts need not rely on guesswork to identify successful deals. **Our research** points to an optimal combination in the C-suite that increases the odds of M&A success: optimistic CEOs tempered by

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pessimistic CFOs.

Optimism and pessimism have been shown to be aligned with the roles of CEO and CFO respectively. CEOs are expected to be **upbeat and open to taking risks** in order to engineer or sustain an upward trajectory for their company. Satya Nadella, Jack Ma and Mary Barra are just a few of the flag-bearers.

However, optimistic vision does not automatically translate into healthy post-M&A return on assets (ROA). This is where CFOs come in. They scrutinise target firms, conduct in-depth due diligence and pinpoint potential risks of any M&A. They are expected to be cautious and attuned to adverse conditions – in other words, pessimistic gatekeepers. Hear it from former Facebook CFO David Ebersman in a 2015 **interview**, “One of the things I felt responsible for doing was to be a bit of a pessimist: to think about what could go wrong with the investments we were making, and to make sure someone was challenging every dollar we were spending in the business.”

The A-Team for shopping

We studied the level of optimism and pessimism of CEO-CFO pairs at 2,356 US firms, the pairs’ influence on 4,529 M&As and, in turn, firm performance. We culled transcripts of conference calls between 2002 and 2013 involving both the CEOs and CFOs, and measured the executives’ optimism and pessimism by analysing their use of positive and negative words. Positive words included “achieve”, “assure” and “successful”; negative ones covered “flaw”, “penalise” and “unavoidable”. *CEO optimism* was calculated as the difference between a CEO’s use of positive words and negative words, and *CFO pessimism* was calculated as the difference between a CFO’s use of negative words and positive words.

Our data showed that CEOs generally used more positive words and were more optimistic than CFOs. CFOs used more negative words and were more pessimistic than CEOs. We then used the ratio of CEO optimism to CFO pessimism to derive what we call the *CEO-CFO relative optimism*. This value is then matched with the firm’s number of M&As and operating performance, assessed in our study as return on assets (ROA) a year later.

We found that the more optimistic a firm’s CEO-CFO pair was (high-optimism CEO with low-pessimism CFO), the more M&As it undertook. High CEO-CFO optimism also correlated with lower ROA a year after M&As. Conversely, low

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CEO-CFO relative optimism was associated with fewer M&As but higher ROA.

At Spectrum Pharmaceuticals, for example, where relative optimism of the CEO (Rajesh Shrotriya) and CFO (Brett Scott) was in the top 5 percentile, ROA was a disappointing -3.4 percent after the firm made an acquisition in 2012. At the other end of our data set were Gilead Sciences' CEO (John Martin) and CFO (Robin Washington), whose relative optimism ranked in the bottom 5 percentile. The biotechnology company reported an ROA of 36 percent a year after making a major acquisition in 2009.

We conclude that in the presence of pessimistic CFOs, optimistic CEOs not only undertake fewer acquisitions, they are less likely to undertake dud acquisitions. This points to an optimal pairing of an optimistic CEO who has a large risk appetite for M&As, and a pessimistic CFO who is sufficiently prudent to alert him or her to potential pitfalls.

Optimism in turbulence

Our findings may have even more relevance in these turbulent times of trade sanctions and **de-globalisation**. In our study, companies with high CEO-CFO relative optimism carried out *more* M&As in a dynamic environment of volatile total industry sales. This suggests that CEOs are more likely to consult CFOs on M&As in times of uncertainty, and when a highly sanguine CEO works with a low-pessimism CFO, the result is likely to be more M&As.

In other words, uncertainty about the operating environment enhances the positive relationship between CEO-CFO optimism and the number of M&As. How optimistic the CEO is, and how pessimistic the CFO is in parallel, will under the circumstances weigh on firms' M&A decisions and their future performance.

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Guoli Chen is a Professor of Strategy at INSEAD. His research focuses on the influence of CEOs, top executives, and boards of directors on firms' strategic choices and organisational outcomes, as well as the interaction and dynamics in the top management team and CEO-board relationships.

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About the research

"CEO-CFO Relative Optimism and Firm Mergers and Acquisitions" is published as a *University of Miami Business School Research Paper.*

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