The CFO as Analyst and Adviser

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Reinventing the CFO:
How Financial Managers Can Transform Their Roles and Add Greater Value

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CHAPTER TWO

THE CFO AS ANALYST AND ADVISER

In our culture, the CFO has always been a part of the business team and, in some cases, grown into leading that team.

—Jim Parke, CFO, GE Capital

SURVEYS SHOW THAT most CFOs want to upgrade their role from accounting specialists to strategic or business partners. But this aspiration has remained exactly that—an *aspiration*. The gap between rhetoric and reality has remained uncomfortably large and reasonably consistent for the past ten years. Few CFOs have actually made the change primarily because they have neither the time nor the necessary capabilities within the current finance team. But for those who have, the rewards have been tangible. They have become trusted and indispensable members of the business development team, people who can add real value through incisive analysis and experienced interpretation of historic and emerging knowledge. The perception of

their roles is also changed. They are seen as business generalists first and accountants second. As one finance manager turned business partner at global carrier UPS put it, "our business is delivering packages, not debits and credits."[1]

Not every CFO shares this vision. Some believe that the finance role should first and foremost be about effective stewardship and scorekeeping rather than business advice and score making. Despite these reservations, over the past fifty years the balance of these roles has been moving inexorably toward the latter activities. This doesn't mean that CFOs can take their eye off the compliance and control ball. Sarbanes-Oxley has been a sharp reminder of the importance of these duties. But neither can the CFO and the finance team use this as an excuse to revert to a bean-counting and controlling role that enables them to avoid eye contact with front line managers faced with increasingly difficult decisions.

What do business partners do that accountants don't? Of course, their accounting expertise is taken for granted. But they are involved in many more tasks such as strategic planning, forecasting, resource management, project management, process improvement, decision support, operational effectiveness, and risk management. Many physically relocate to operations away from the finance center and become an integral part of the decision-making team. This means continuous involvement, not just checking or validating decisions that have effectively been made. Another change is that they no longer just provide the information that operations people request. They bring all their knowledge and experience to bear on planning options and key decisions. Their approach to investment proposals and other project-based decisions is constructive skepticism rather than outright cynicism. They challenge their colleagues, sometimes to the point of disagreement. And they take strong positions that are immovable if they believe that ethical lines are being crossed.

Finance experts turned analysts and advisers have another selling point. They are generally seen as independent members of the team with no vested interests in decision outcomes. Whereas marketing people are focused on market share and production people

on volume and quality output, finance people are just interested in making the right decision. And if the risks are too great for the potential returns, they will say so.

However, there are a number of important steps that the CFO and the finance team need to take to be in a position to act as trusted and valued business partners. Thus the CFO needs to:

- Strike the right balance between control and decision support
- Build a high performance team
- Use technology to deliver high quality information
- Provide effective decision support

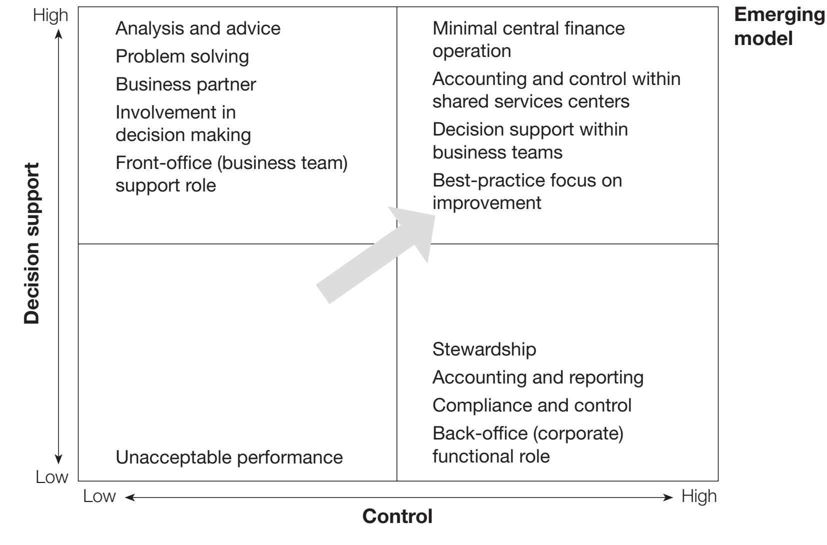
Strike the Right Balance Between Control and Decision Support

Some CFOs feel uncomfortable with becoming business partners first and controllers second. They believe their role is to be independent and objective and not be too involved in decision making. At French oil company Total, CFO Robert Castaigne defines his role as "cautionary counterweight" to CEO Thierry Desmarest, whose bold acquisition and investment strategy over the past decade has transformed Total into the world's fourth-biggest oil company. Whereas Desmarest is always optimistic, Castaigne feels that his duty is to be a bit of a doomsayer to ensure that things don't go wrong.[2] Others see their primary roles as analysts and advisers, with compliance and control being farmed out to specialist internal teams or even outsourced completely. Perhaps a new finance model is emerging (see figure 2-1). In this model the central finance operation becomes a small specialist team setting standards and best practices and supervising the work of finance managers in (a) the "accounting and control" team and (b) the "decision support" teams within the lines of business.

This is the model chosen by General Electric. Since its first investment in 1997, GE Capital has been building its finance capabilities

FIGURE 2-1

An emerging model for the finance role



in India (the operation is known as GE Capital International Services, or Gecis). Following a number of acquisitions in the 1990s, by the early 2000s GE Capital decided to reduce costs by around a billion dollars per year. According to CFO Jim Parke,

> We focused on two lines of attack. One was to consolidate our systems and take a lot of the manual activities out. The other was to consolidate as much activity as we could in India and we grew the GE Capital International Services business to a total of seventeen thousand people (eleven thousand in financial services). We've just sold 60 percent of it to some financial buyers because we thought they could do a better job growing the business with external customers. We love the capability that it brought us because it combined perfectly with the whole push on controllership. They could put control mechanisms in (even if it was manual for a while) that we had a difficult time doing

> in the United States or Europe. They also adapted to Six Sigma better than anybody else in the world. The intellectual capital in India is incredible. This might seem odd to some people but we don't think of them as outsourcing contractors. We think of them as our people in India doing this activity for us, and we take that same responsibility—if it's not getting done right it's because we aren't doing it right.[3]

Gecis now manages 450 processes (split into centers of excellence) categorized by industry or function. As well as handling all transaction processing, the finance and accounting center of excellence, comprising 250 employees (average age, twenty-seven), crunches the relevant data to provide analysis and reports on a whole range of issues from inventory returns to the use of cash and productivity improvement. Perhaps this is a glimpse of the future of finance—just a few people in head office being served by highly effective teams in service centers who perform not only basic accounting work but also provide a complete service including data analysis and reporting. At the analytics center of excellence, the seven hundred statisticians, MBAs, and PhDs on the team serve as quasi–vice presidents of their GE business clients. They create models from which market strategies are made and conduct due diligence for GE's targeted acquisitions.[4]

Charging GE businesses at arm's-length prices has enabled Gecis to make $404 million in revenues in 2004. All told, says VN Tyagarajan, head of global business development, GE units saved 35 to 40 percent on cost alone. He estimates another 40 percent is saved when a client relationship reaches three years, because by then the benefits of Gecis's drive for process improvement start to kick in. This is where CEO Pramod Bhasin thinks the future of outsourcing lies. "Too much of what is happening today is still what one of my customers calls 'My mess for less,'" he says. "They're just moving the work, and you're just executing the work. Not enough is being done around process expertise and domain knowledge." Improving the process that's outsourced, he argues, can deliver savings equivalent to the labor arbitrage benefits."[5]

Build a High-performance Team

It is highly unlikely that finance managers will be invited to join the business development team unless they have relevant knowledge and are capable of pulling their weight. But more than two-thirds of CFOs feel they need to do more to motivate people and invest in the capabilities of their staff. Another problem is the skills of CFOs themselves. Even though they consider this to be the most important enabler of a high-quality finance organization, they recognize that they are poor at coaching and development (only 22 percent rated themselves highly at these skill sets).[6] And finally there is little doubt that credible expertise in analysis and advice is the passport to becoming a valued business partner. At average companies only 58 percent of analysts have operating knowledge, against 100 percent of analysts at leading organizations.[7] "Not surprisingly," according to David Axson, "analysts working for best-practice organizations are held in higher regard by operating management with over 90 percent considered to be business partners."[8]

But to get to this position, finance needs competent people to interpret the flow of information and support operating managers at every level. Jonathan Chadwick, Cisco Systems' VP for finance and planning, put it this way: "What we need to be able to do is actually to provide the business with intelligence that can provide a different perspective or different decision points or opportunities to our business people."[9] Kent Potter, CFO of Chevron Phillips, a $6 billion chemicals joint venture between Chevron Texaco and Phillips Petroleum, also believes that this is the critical step toward transforming the finance operation. "Ultimately", he said. "the 10 percent or so of the companies in America that have really transformed their finance departments have done it by changing people."[10] CFOs need to recruit the right people and then develop their skills. But this is a challenge that many CFOs struggle to meet. In fact, finding and keeping capable and committed people is now one of the biggest problems facing the CFO.

Recruit the Right People

The CFO's problems begin with the recruitment process. Too many finance people are recruited on the basis of fit with the job rather than fit with the culture. Unfortunately, the majority of finance managers are not well endowed with analytical and communication skills. The key to Southwest Airlines' responsibility culture is that it hires the right people—those that have the right attitude. As Chairman Herb Kelleher has said, "If you don't have a good attitude, we don't want you, no matter how skilled you are. We can change skill level through training. We can't change attitude."[11]

Finance professionals must also be adaptive. In many industries, the business changes rapidly but the finance staff doesn't adapt quickly enough. It is a real handicap if a person is competent at only one job. It also leads to instability if key people leave the organization, and it is time-consuming and expensive—if new people are required, it takes on average forty days to find a replacement and costs over $50,000 to replace a mid- to high-level finance employee.[12] Most employees change jobs every three years, which can leave the finance department in a constant state of flux.[13] Blake Barnet, CFO of Yan Can restaurants, a unit of Yum! (which also owns Pizza Hut and Taco Bell) says his goal is to hire fewer, but better, employees. His main criteria are that they be bright, be able to learn about the various aspects of the business quickly, and be relationship builders. "The need is greater for this kind of person today", says Barnet. "Previously, you had people who were strictly finance, but now you need both depth and breadth."[14]

In some cases, the finance team is already supremely competent; they just need some disciplines and principles to guide them. This is what Thierry Moulonguet, ex-CFO of Nissan (and current CFO of Renault) found when he embarked with CEO Carlos Ghosn on the Nissan Revival Plan following the Renault acquisition in 1999. As Moulonguet explains, "this was a paradox and it was the same right across Nissan. The people were very competent

and capable. We didn't hire one extra person [in finance]. I just came with one or two French colleagues. We worked with the finance teams all around the world. There was a lot of openness and exchanges of views. The result was that with everyone now using the same principles, the finance function moved itself from playing a minor role to performing on the center of the stage."[15]

Improve Communication and Teaching Skills

Communicating with analysts and investors is increasingly becoming a core competence for CFOs. According to Siegfried Luther, CFO of Bertelsmann AG, the German media company, "the CFO should be half accountant and half strategist and, to an increasing degree, an efficient communicator in both roles."[16] But it is easy to get it wrong. as Anne Mulcahy discovered just after she had taken over as CEO of Xerox. "It was October 2, 2000—my second conference call with investors and a deep, dark time for Xerox,"she notes. "It was clear to me that a company that was losing money had an unsustainable business model. My intent was to say just that, as a recognition that we 'get it.' That is, we understand this can't get better by itself. I made a mistake. No question. And I have to say I was even warned. Colleagues have said 'Ooh, do you really want to say that?' But I was naive enough to think that you got rewarded for being totally honest about the nature of your problems."[17]

Communicating complicated accounting changes is testing the skill levels of many CFOs. For example, the switch in 2005 to international accounting standards requires extensive consultation with the analyst community to explain the impact on company accounts. Analysts also want more dialogue around strategy. "All you can ask of a CFO is that they elucidate a clear strategy and execute it. You want them to show that they are in control of the risks and that they can control and explain what the other risks are. When a CFO does that, it gives an investor confidence and makes investing in that company easier," says Andrew Dickson, managing partner at a U.K. hedge fund.[18]

Boards are recruiting CFOs with exceptional communication skills. One CFO who clearly landed his job through his ability to communicate with investors was Philippe Crouzet, now CFO of French glass and building materials company Cie. de Saint-Gobain. Crouzet believes that investors want more than just numbers. "They want to hear stories about what is going on," says Crouzet. He was also prepared to listen and learn from investors. Previously he thought that maintaining high inventory levels was a smart way to serve customers, but after listening to investors' concerns about reducing inventories he tightened up on inventory levels. The result has been that, although sales increased by €2.5 billion, the company's working capital increased by only €100 million.[19]

CFOs are also realizing that there is a real and growing need for their finance managers to be effective communicators. They need to spend more time teaching their business colleagues the rudiments of financial analysis. This was the approach taken by the accountants at Caterpillar, who took on the burden of educating various divisions about what the numbers meant and how these numbers could impact them. The accountants developed a program called "Understanding the Business 101" that they presented to all eleven hundred salaried and all two thousand hourly people in one particular business unit. The employees learned what financial results are, how the accountants compiled the information, and how it was used to measure performance. The accountants explained how a welder impacts the business and how a purchasing officer impacts the business. In effect, by communicating effectively, they helped to create thousands of businesspeople.[20]

Like CEOs before them, some CFOs are being turned into media figures as increasing numbers of financial news networks search for interviews and other content to fill their schedules. This also tests their communication skills, since few financial journalists seem to be able to understand complex financial issues. According to David Devonshire, CFO of Motorola, "I think their understanding has improved, but it's still not near where it should be . . . I hope they'll start to see that the one thing that keeps you honest is cash flow."[21]

Ensure That Finance Managers Understand the Business

Some CFOs are making sure that finance professionals gain the right experience by placing them within the business teams rather than in central finance or geographic locations. Others provide extensive training and development programs. Intel, for example, has a project under way to develop its finance employees' skills. This includes building leadership abilities and training people to think strategically. According to Leslie Culberston, VP of finance, "changing the way finance operates requires people at all levels of the function who can help drive change. Additionally, finance needs employees who can communicate with other parts of the business. A big piece of this is to have the ability to have a good network inside the company and working relationships with the rest of the senior managers within the corporation so that you're viewed as a supportive role, helping the business make the right call.[22]

Cathy Ross, CFO of FedEx Express, speaks for most enlightened CFOs when she says "I encourage people within finance to leave the division and work elsewhere in the company. It helps the company and it broadens the individual."[23]

Building a Top-Quality Team at GE Capital

GE Capital is renowned both within the General Electric group and across corporate North America for having a superb finance operation. When asked what was his greatest accomplishment after fifteen years as CFO at GE Capital, Jim Parke said that is was to move from a net income of around $950 million when he first became CFO in 1990 to over $9 billion in 2005. "It's all about how to grow the business over those fifteen years and do it in a way that involves acceptable risks over various economic cycles," he says. He has little doubt that this success has been based on the quality of his people. The company has developed a financial management program that is the envy of other large corporations. Parke tells us how they do it:

For me, the quality of the people is the name of the game. We've established several developmental programs that are, I think, quite unique. One is that we have a financial management program that hires talented undergraduates. It doesn't matter if they know anything about debits and credits (I didn't when I came on board). This is a two-year program in the basics of finance with rotational assignments and classroom studies. We also have an audit group that is really a leadership development program. When they graduate from the financial management program, we encourage the best to go on the audit staff. Audit also takes high-potential people from other functions as well. It is a two to five year program; every year you either go up or out.

The big cut is after two years (the maximum is five). I know this sounds inefficient and that they don't have enough experience, but I'll put that group of people over the years against any audit group in the world. They are the best. They have free rein to do what they want and go where they want. They set their own agenda, which they coordinate with our external auditors (KPMG). It's a 24/7 very intense work program. They are away from home 95 percent of the time, but the good news is that there's light at the end of the tunnel. When they finish the program after four or five years, they invariably go into senior finance positions. There is a culture that accepts that talent, knowing what they've gone through, and knowing what their predecessors have done. It also means that people have judged you to have the talent—whether you have the experience or not is less important—so they know that they're getting smart people who know the culture and the business. It is also rigorous, probably one of the most intense learning opportunities I've ever seen.

This program is counterintuitive to almost everyone until they've had the opportunity to experience it. We recruit from around the world (50 percent have non-U.S.

> passports). At my insistence, after two years they have to decide whether to focus on financial services or the industrial/service part of the company. We require half of them to focus on financial services because auditing and understanding risk is different from the rest of the company. It has allowed us to produce a lot of people who have good understanding of various GE businesses, and the risks in each of them. After the audit assignment, these people find senior roles right across the GE group.[24]

Use Technology to Deliver High-quality Information

The finance team will lack credibility unless it can use technology to provide a fast, integrated information system that delivers relevant knowledge and timely reports to operating managers. The design and implementation of these information systems is critical. The reason most new tools and systems fail to live up to their hype is that they are implemented from the center and are therefore seen by frontline troops as just another control weapon in the battle between head office staffers and frontline teams. The result is lack of buy-in and enthusiasm. In one survey, 53 percent of companies said they had the right ERP systems but didn't use them well.[25] The level of wasted investment is huge.

The trick is to involve local teams at the thinking and planning stage. If they can be convinced of the needs and benefits of ERP systems, then there is a fighting chance that they will support them. But if all they see are training programs and many more reports to prepare, against which their performance will be assessed, then you can say goodbye to the prospect of any goodwill, especially because those reports are likely to add to their existing workload.

If finance fails to get involved in the design and procurement of new systems, then it will only have itself to blame if these systems fail to deliver what the organization needs. In other words, what

will be delivered will be the “default” management information system offered by the IT vendor. whose vision for finance is too often rooted in Vision A—more detail, drill-downs, and micro-management. The CFO needs to take charge of systems design and demand that IT deliver what managers need; that is, fast, relevant information. Cisco CEO John Chambers notes the benefits of this approach when he says “I can now close my books in twenty-four hours. I’ve known for a month what my earnings are for this weekend. I know my expenses, my profitability, my gross margins, my components . . . Once I have my data in that format, every one of my employees can make decisions that might have had to come all the way to the president . . . Quicker decision making at lower levels will translate into higher profit margins. So instead of the CEO and CFO making fifty or a hundred different decisions a quarter, managers throughout the organization can make millions of decisions. Companies that don’t do that will be noncompetitive.[26]

Develop Integrated Systems

The HealthSouth case provides a sharp reminder of what can happen without integrated systems. Incredible though it sounds, a stream of five CFOs shielded a systemic fraud from investors over a six-year period as around $2.7 billion of faked revenues were booked to protect earnings and share price. But key to making this fraud possible was the disconnection between business-unit accounting systems and the corporate accounting system (the WorldCom case was similar). The consolidation of group accounts was done by hand, just like a 1960s manual private ledger kept under lock and key (I remember many of these from my early auditing days). Thus the checks and balances that normally flow from the finance team observing the transaction traffic through the consolidation system were absent. Auditors Ernst & Young noted in the 2001 accounts that “management is dominated by one or two individuals without effective oversight by the board of directors or audit committee.”[27]

While this might be an extreme case, many organizations suffer delays and high error rates because information systems are fragmented and disconnected. Most cannot talk to each other. This problem is often the result of a series of acquisitions over several years. But software vendors are now shrinking the problem by providing reporting and consolidation capabilities that can draw data from disparate systems and make it look more like an integrated system. The ultimate goal is to have one unified system for the whole organization. One immediate advantage is the time saved in rekeying data as well as reducing the need for huge numbers of month-end journals.

Another advantage is that finance can use integrated platforms to build business rules and structures, then modify systems as their business evolves, easily accommodating changes such as extra locations, new or discontinued product lines, or restructured cost centers. Many of these systems have powerful modeling capabilities that enable teams to flexibly devise, compare, and assess alternative business scenarios. Such systems allow teams to build models in days rather than months. Data definitions can be imported from other sources like ERP and general ledger systems. They also enable cross-functional models to be built.

Tomkins is one company that has used technology effectively to deliver tangible results. CFO Ken Lever explains how:

> We make extensive use of the Internet to improve the speed and processing of transactions. The groupwide transaction processing system has enabled us to improve efficiency enormously. All the operating businesses can download their own information into this system. This, together with our consolidation system, sits on top of the systems that the individual businesses run. We have many different operating businesses that use their own ERP system. So what we have done very effectively is to use technology to transfer data from those systems into our central reporting system as seamlessly as possible and we now do very little rekeying of data from one system to another. This has saved us an enormous amount of time and cost. I'm

> not saying that we don't do any rekeying of data but it has reduced dramatically, and we are continually looking at ways of eradicating this type of work. We've also used technology in other areas. For example, our capital investment appraisal process is now fully automated. This has speeded up the investment process considerably. Whereas previously we had a lot of manual documents floating around the system, this is all now done electronically.[28]

Integrated systems also reduce the dependency on closing the books quickly at the end of the month or quarter. In fact, while some best-practice companies close the books at lightening speed (in some cases within one day), many others do not depend at all on a fast close. Jim Parke, CFO of GE Capital, doesn't think it's all that important because managers have most of the basic information that they need when they need it: "We just don't have the final net income figure. We know our operating costs; we know what people we have (that's our biggest cost); we know our interest expense and we know the value of our assets. We can get at these numbers at a moment's notice. So not closing the books quickly doesn't slow us down or in any way handicap our business decisions. Getting it all together quickly is only a problem for external reporting."[29]

Another benefit of integrated systems is the enhanced effectiveness of decentralized decision making. While those at the corporate center can see patterns, trends, and exceptions, they need to interfere only when they see movements that trigger a dialogue. This leaves local managers free to spend all their time developing the business rather than dancing to the tune of top-down control systems such as budgets and variances.

Reduce the Dependency on Spreadsheets

According to a 2003 IBM survey of 450 CFOs, spreadsheets continue to dominate planning processes in over 80 percent of organizations.[30] While this is fine for local requirements, spreadsheets can cause problems when they need to be aggregated across

and up the organization. It is also apparent that in large organizations, different units use different assumptions, algorithms, and software. This makes it difficult to combine and consolidate forecasts. According to Gary Crittenden, CFO of American Express, "spreadsheets are great for individual productivity work but they cause problems when there is a lot of sharing and aggregation going on. Using driver-based forecasts together with dedicated systems and Web technology enables hundreds of managers to work on forecasts together and aggregate the outcomes to the highest level, thus providing more control than ever to the board. The new approach has enabled us to standardize on a single methodology and align key assumptions and algorithms across the organization."[31]

Sarbanes-Oxley is also driving another nail in the spreadsheet-as-integrated-planning-tool coffin. In theory at least, every change to a formula or even a number of rows needs to be documented. This will undoubtedly make it more difficult for organizations to rely on traditional spreadsheets. Even Microsoft recognizes the problem. "There's an inherent tension between the 'power-to-the-people' origins of Excel and the role it is increasingly called on to play," says Marc Chardon, CFO of Microsoft's Information Worker division (which is responsible for Excel).[33] Needless to say, Microsoft is working on a new version that is better suited to collaborative work.

Building a Fast, Integrated Information System at Cognos

Cognos is a world leader in business intelligence and performance planning software for the corporate performance management (CPM) market. Before joining the company as CFO in 2001, Tom Manley just didn't realize how technology could improve both the quality of information and how it could be delivered in a much more effective way to key people around the organization. "Over the past two to three years we have become a test-bed for all our own products," notes Manley. "In the early phase we had disconnected business intelligence and were not really working

toward a single view of the business. We had too much data and too little knowledge."[33]

So he and CEO Rob Ashe kicked off a program called "CPM at Cognos." But it was not only about optimizing the use of their own products; they also wanted to learn how they could move toward a better CPM environment and take their customers with them on the journey. After designing their corporate strategy map and scorecard they communicated it to the entire company. Employees were told that they all had access to the corporate scorecard, including descriptions of the detailed metrics, so everyone knew how they fitted into the strategic picture. Then each of the functions built its own strategic road map to fit in with the corporate one, and then enriched the entire environment with thoughtful reports. At the same time, they provided lots of information so that people could do their own analyses and make sure that they were making the right decisions relative to the overall strategy.

But the real key to getting full acceptance was the reform of the planning system. Up to this point many people felt that they spent half their lives feeding a planning system that provided precious few benefits. Manley and Ashe wanted to turn this around by providing a system that would minimize people's input time and leverage their knowledge to influence their future direction. Manley explains:

> I envisioned an environment where the information network was so efficient that our people could just absorb key information every day. New information would be a simple act of updating the plan, which was designed for handling constant, dynamic input. The planning environment would become a value-added support system for decision making. Instead of drowning in numbers, I wanted managers to focus on how they were going to allocate resources and what they were doing strategically to improve their performance. I wanted people to be focused on what they could influence as opposed to doing a lot of analysis that they put in a drawer and never looked at again.

Let me give you an example from my own perspective. I come in every morning, turn on my computer, and go straight to my BI [business intelligence] environment, where I see five different reports. The first report tells me every deal that we've closed in the last twenty-four hours. The second report tells me about any deals in the pipeline that have changed in the last twenty-four hours with some threshold. The third report tells me about any deals that have slipped from one quarter to the next. The fourth report tells me about all the big deals that we are tracking in a quarter so I know to whom we're selling on an ongoing basis. And the fifth report is a summary that basically tells me where we are from a revenue point of view. That takes me only ten to fifteen minutes because when you're used to the reporting framework you're just looking for the changes and the exceptions.

The real challenge was to hold people accountable for that information. But I have to say that with all the current attention on compliance, the integrity of the data is getting stronger every day. Yet I know that's not sufficient on its own. We also need to break the traditional mind-set that the planning and budgeting process is a game of negotiation instead of being the outcome of good planning. Best-in-class planning solutions support the activities of how management works—which in most cases means thinking about the next actions and the go-forward view of the business. Only a small portion of a manager's time is spent analyzing the historical results. I think that as more information becomes readily available and people are looking at information differently, the ability to negotiate starts to dissipate. And I think that's starting to happen.

Provide Effective Decision Support

The CFO and the finance team need to be independent and objective participants in the decision-making process. They should

always ask the awkward questions and, where appropriate, be prepared to challenge conventional wisdom. They should also be prepared to go beyond the obvious numbers and look at the wider ramifications of particular decisions. They should look at hidden costs and best practices elsewhere.

Be a Skeptic, Not a Cynic

The CFO should maintain a staunchly independent view about management decisions. It is too easy to go with the flow, especially when the firm appears to be making profits and growing rapidly. Many companies have seen their good run come to a grinding halt through one poor decision, perhaps based on a misjudged acquisition. Every acquisition is based on long-term forecasts—usually showing synergy, cost savings, or other benefits of combining two organizations. But these long-term forecasts are often self-serving and difficult to challenge. One writer has this advice for CFOs looking at long-term forecasts: "Distrust computer-driven models that convey a spurious air of authenticity to the exercise but are based on no-less suspect assumptions that any more mundane approach. Distrust elegance and complexity. Prefer judgment to technique."[34]

The CFO is often placed in a difficult position with regard to the board and especially the CEO. Many CEOs are serial acquirers who see their role as creating shareholder value instead of managing the business. They are often egged on by investment bankers who keep telling the board that the company's share price will continue to underperform unless the organization can grow more rapidly. This is not easy without an acquisition or two.

But according to a report by KPMG, only 30 percent of acquisitions add value to the shareholders of the acquiring company.[35] The CFO should be particularly skeptical about synergy-type benefits, especially cost savings. While such benefits look seductive on spreadsheets, the reality is that the pain and costs of restructuring existing and new businesses, and the collapsing morale it brings in its wake, outweigh any cost savings. Campbell and Goold have conducted extensive research into the effects of "synergy." This

comment encapsulates their views: "This thirst for synergy creates optical illusions. Parent managers, often supported by business managers, believe that synergy already exists and that further initiatives will reveal more synergy benefits that up till now have been hidden from view. If parent managers *want* to believe that synergy opportunities exist, it is comparatively easy to make a case in favor—especially given the problems of precise cost/benefit analysis."[36]

The very mention of the word *synergy*, according to strategy expert Gary Hamel, should send investors running for the door. "It's time to beware when the CEO loads up the balance sheet with billions of dollars worth of fixed assets on the basis of something as ethereal as synergy," notes Hamel.[37] The reality is that few grand strategies come to fruition, and very few longer-term forecasts are worth the paper they are written on. In an unpredictable world, the emphasis should be on flexibility and speed of response rather than strategic planning.

Investing in knowledge management systems is another example of how the skeptical CFO can save the company from going with the flow and increasing complexity and cost. Instead of debating the merits of investing in expensive knowledge management systems, the wise CFO would be better advised to address these questions: "What is stopping us sharing knowledge?" followed by "How do we remove these barriers?"

The reasons that managers fail to share knowledge are often concerned with how performance management systems work. Managers are placed in business unit silos, told to meet a range of financial targets, and then given incentives to meet them. This approach guarantees that little knowledge will be shared across the organization, since every manager has a vested interest in looking after his or her own part of the business. Some see other business units as the real enemy, rather than the external competition. Another barrier to knowledge sharing is that measures are separated from the work people do. If senior management forces workers to follow procedures (assuming that knowledge is accumulated in the hierarchy), then it is hardly surprising that workers

will unplug their brains when they enter the workplace and follow the rules.

John Browne, CEO of BP-Amoco believes that knowledge sharing must start by creating the right climate. The top management team must stimulate the organization, not control it. Its role is to provide strategic directives, to encourage learning, and to make sure there are mechanisms for transferring the lessons. "The role of leaders at all levels is to demonstrate to people that they are capable of achieving more than they think they can achieve and that they should never be satisfied with where they are now. To change behavior and unleash new ways of thinking, a leader sometimes has to say, 'Stop, you're not allowed to do it the old way,' and issue a challenge," notes Browne.[38] The CFO needs to follow Browne's advice and remove the barriers to knowledge sharing. He must recognize that investing in expensive systems may not be the right approach.

Challenge Conventional Wisdom

Is increased market share always good? Is every customer a good customer? Do sales incentives drive performance improvement? Is maximizing volume production the best way to reduce unit costs? On the face of it, most finance managers would answer "yes" to these questions, though many would also be alerted to hidden problems. Pursuing market share can drive up costs and bring in the wrong (unprofitable) customers. In a large population of customers, 20 percent are likely to account for 225 percent of profits, while 80 percent "lose" 125 percent of profits.[39] The problem is that managers have no idea which customers make up the 20 percent and which make up the rest. Sales incentives can be highly dysfunctional and attract mercenary salespeople who stick around only as long as they are making maximum bonuses. When these tail off, they move on to the next gullible employer and try their best to take their customers with them.

Putting quality before volume is a smarter way to improve long-term profitability as Toyota and others have discovered.

Let's just zoom in on one of these issues—"good" customers. To most marketing managers and salespeople, every customer is a good customer and every sale is a good sale if it covers its direct costs (thus making a contribution to overheads). The result is that the accounts receivable ledger grows like gangbusters and salespeople pursue every sales opportunity. What's missing is *a method of evaluating whether customers (or customer segments)—both existing and targeted—are worthwhile.* In other words, there is little concern with which customers to keep, which have untapped potential, which are strategic, which are unprofitable, and which should be abandoned. Most marketing programs are simply aimed at replacing the 20 percent of customers the firm expects to lose each year, without any consideration of whether resources would be better spent on keeping them than attracting the replacements. Fred Reichheld and Earl Sasser have noted that a 50 percent cut in defections will more than double the average company's growth rate.[40]

What advice should the CFO give? He should encourage marketing, sales, and finance to sit down together to review the customer portfolio (perhaps with representatives from service, support, and credit control). Among them they should look at whether customers are either strategic, profitable, neither, or both. Customers can be strategic for many reasons. It helps if they buy for reasons of "value" rather than "cost." Dell exited the first-time user segment of the PC market in the early 1990s for exactly these reasons. Its value proposition was geared to more sophisticated users who knew what they wanted and required relatively little support. There are other reasons why a particular customer may be strategic. For example, one customer may well influence others. Dealing with one customer in a particular area or technology platform can be the gateway to many others—whether a community, a territory, a group of companies, or perhaps an economic web. Many other strategic relationship questions spring to mind. Is the customer likely to grow? Can we learn from the customer? Can we follow a particular customer into a new market opportunity? Does the customer have special technology or excellent systems from

which we can benefit? Unless the CFO and business-unit leaders ask these types of questions, the underlying importance of customers will remain unrecognized and their full potential unexplored.

Customers must also be profitable. Though most finance departments provide customer profitability analysis at the *gross* profit level (i.e., revenue less direct costs), few provide it at the *net* profit level (i.e., after charging all the "below-the-line" costs of serving and supporting customers). But to sales and marketing teams, this information can be priceless. They might realize, for example, that some of their largest customers are also their biggest loss makers. These are the ones that take all the special offers at the end of the quarter, soak up all the promotional budgets, take all the discounts and other benefits going, return goods at the slightest suspicion of a fault, demand special deals and inventory call-offs, pay late, and more generally take weeks of valuable management time.

What should be done with an unprofitable customer? Unless the case is hopeless, the first action is to try to make that customer profitable. There are usually reasons underpinning the profit problems. For example, transaction costs may be too high or delivery and support costs may be excessive. Every case needs looking at on its merits. Once armed with this knowledge, sales and support people can at least meet with the customer and work out ways of making the relationship more valuable for both parties. The ideal customer is both strategic and profitable. The team should build a profile of what such a customer looks like and then try to gradually switch the balance of the customer portfolio. After the review the team will be in a better position to pass all its nonstrategic, unprofitable customers onto its competitors.

Becoming a Valued Business Partner at American Express

Under the leadership of CFO Gary Crittenden, American Express has transformed its finance operation. Most importantly, Crittenden

has raised finance's game to a level where the team is now an indispensable business partner:

> I think that finance is such an integral part of how the "business does business" that no one would think of doing anything without a clear understanding of what their options were, and it just happens to be finance's job to do that. So if you're on the outside trying to shoehorn your way in, that's a tough job. But if you're actually part of the business team constantly thinking ahead, operating managers will seek you out. They want to know what your input is before they have to make difficult choices. We provide the information and structure the options in a way that they need to make effective decisions. It's the same as having relationships with customers so that they *want to deal with you* instead of constantly trying to persuade them to buy your products and services.
>
> We have some really talented people, but the trick is to find the time for them to use their knowledge to support the business. We've done this by reorganizing the way we do things, especially in the back-office part of the finance process. One of the things I always say about our business unit CFOs is that presidents fool me into thinking that they work for me when in reality they work for their business-unit CEOs. I think these business-line CFOs recognize the accountability they have to the group finance function by ensuring that they have the right controls in place and are following consistently good practice. But their real focus is on supporting their business managers. And that's how it should be.[41]

Operating managers must value finance for its knowledge and contribution to strategic planning and execution before it can earn its place in the business development team. Upgrading the competences of the finance team and the relevance of the technology it uses are both key elements in this process. But how the team

provides and communicates decision support knowledge is really what makes it an indispensable player. However, even greater opportunities lie ahead for the ambitious CFO who really wants to make an impact on the whole performance of the organization. Changing management behavior from managing numbers to improving the business is the big opportunity. The next four chapters will show what an ambitious CFO, backed by a competent and committed team, can really do if they try.

A CHECKLIST FOR THE CFO

- ☐ Aim to be a trusted and indispensable member of the business development team. But also recognize that this cannot be achieved unless effective accounting systems and controls are in place.
- ☐ Reduce the central finance function. Place more finance managers in operating teams. Make the core finance group a center of excellence, setting and maintaining the highest standards.
- ☐ Be careful when outsourcing. Don't go for the "my mess for less" value proposition. Agree with the service provider to work together to improve the process over time so that the mess (and the cost) is reduced.
- ☐ Build a high-performance team with good analysts and communicators who are also capable accountants.
- ☐ Start by recruiting the right people. Look for the right attitudes (team players) and communication skills first and technical skills second. Skills can be improved; attitudes are hard to change.
- ☐ Work to improve communications skills at every level. Turn finance managers into teachers and mentors who help business managers improve their financial knowledge.
- ☐ Ensure that finance managers understand the business. If the business structure allows it, give all key finance people experience in business teams.

- ☐ Develop integrated information systems that fit with your performance management vision. Focus these systems on the needs of frontline teams.
- ☐ Use dedicated planning tools and reduce your dependency on spreadsheets for planning, forecasting, and consolidations.
- ☐ Provide effective decision support by maintaining an objective, independent view (be a skeptic, not a cynic).
- ☐ Challenge conventional wisdom where appropriate.
- ☐ Look beyond the numbers. Seek out hidden costs and look at the strategic impact of key decisions.

NOTES

CHAPTER 2

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