

# PART ONE

## Overview

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## CHAPTER ONE

# CFO's Place in the Corporation

**Y**EARS AGO, CHIEF EXECUTIVE officers (CEOs) were satisfied with finance chiefs who could manage Wall Street analysts, implement financial controls, manage initial public offerings (IPOs), and communicate with the board of directors—who, in short, possessed strong financial skills. However, in today's business environment, the ability to change quickly has become a necessity for growth, if not for survival. CEOs are no longer satisfied with financial acumen from their CFOs. They are demanding more from their finance chiefs, looking instead for people who can fill a multitude of roles: business partner, strategic visionary, communicator, confidant, and creator of value. This chapter addresses the place of the CFO in the corporation, describing how to fit into this new and expanded role. It also describes the roles of three key subordinates—the controller, treasurer, and investor relations officer.

## FIRST DAYS IN THE POSITION

You have just been hired into the CFO position and have arrived at the offices of your new company. What do you do? Though it is certainly impressive (to you) to barge in like Napoleon, you might want to consider a different approach that will calm down your new subordinates as well as make them feel that you are someone they can work with. Here are some suggestions for how to handle the critical first few days on the job:

- *Meet with employees.* This is the number-one activity by far. Determine who the key people in the organization are and block out lots of time to meet with them. This certainly includes the entire management team, but it is even better to build relationships far down into the corporate ranks. Get to know the warehouse manager, the purchasing staff, salespeople, and engineers. Always ask who else you should talk to in order to obtain a broad-based view of the company and its problems and strengths. By establishing and maintaining these

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linkages, you will have great sources of information that circumvent the usual communication channels.

- *Do not review paperwork.* Though you might be tempted to lock yourself up in an office and pore through management reports and statistics, meeting people is the top priority. Save this task for after hours and weekends, when there is no one on hand to meet with.
- *Wait before making major decisions.* The first few months on the job are your assigned “honeymoon period,” during which the staff will be most accepting of you. Do not shorten the period by making ill-considered decisions. The best approach is to come up with possible solutions, sleep on them, and discuss them with key staff before making any announcements that would be hard to retract.
- *Set priorities.* As a result of your meetings, compile an initial list of work priorities, which should include both efficiency improvements and any needed departmental restructurings. You can communicate these general targets in group meetings, while revealing individual impacts on employees in one-on-one meetings. Do not let individual employees be personally surprised by your announcements at general staff meetings—always reveal individual impacts *prior to* general meetings, so these people will be prepared.
- *Create and implement a personnel review system.* If you intend to let people go, early in your term is the time to do it. However, there is great risk of letting strong performers go if you do not have adequate information about them, so install a personnel review system as soon as possible and use it to determine who stays and who leaves.

The general guidelines noted here have a heavy emphasis on communication, because employees will be understandably nervous when the boss changes and you can do a great deal to assuage those feelings. Also, setting up personal contacts throughout the organization is a great way to firmly insert yourself into the organization in short order, and doing so makes it much less likely that you will be rejected by the organization at large.

### ■ SPECIFIC CFO RESPONSIBILITIES

We have discussed how to structure the workday during the CFO's initial hiring period, but what does the CFO work on? What are the primary tasks to pursue? These targets will vary by company, depending on its revenue, its industry, its funding requirements, and the strategic intentions of its management team. Thus, the CFO will find that entirely different priorities will apply to individual companies. Nonetheless, here are some of the most common CFO responsibilities:

- *Pursue shareholder value.* The usual top priority for the CFO is the relentless pursuit of the strategy that has the best chance of increasing the return to shareholders. This also includes a wide range of tactical implementation issues designed to reduce costs.

- *Construct reliable control systems.* A continuing fear of the CFO is that a missing control will result in problems that detrimentally impact the corporation's financial results. A sufficiently large control problem can quite possibly lead to the CFO's termination, so a continuing effort to examine existing systems for control problems is a primary CFO task. This also means that the CFO should be deeply involved in the design of controls for new systems, so they go online with adequate controls already in place. The CFO typically uses the internal audit staff to assist in uncovering control problems.
- *Understand and mitigate risk.* This is a major area of concern to the CFO, who is responsible for having a sufficiently in-depth knowledge of company systems to ferret out any risks occurring in a variety of areas, determining their materiality and likelihood of occurrence, and creating and monitoring risk mitigation strategies to keep them from seriously impacting the company. The focus on risk should include some or all of the following areas:
  - *Loss of key business partners.* If a key supplier or customer goes away, how does this impact the company? The CFO can mitigate this risk by lining up alternate sources of supply, as well as by spreading sales to a wider range of customers.
  - *Loss of brand image.* What if serious quality or image problems impact a company's key branded product? The CFO can mitigate this risk by implementing a strong focus on rapid management reaction to any brand-related problems, creating strategies in advance for how the company will respond to certain issues, and creating a strong emphasis on brand quality.
  - *Product design errors.* What if a design flaw in a product injures a customer, or results in a failed product? The CFO can create rapid-response teams with preconfigured action lists to respond to potential design errors. There should also be product design review teams in place whose review methodologies reduce the chance of a flawed product being released. The CFO should also have a product recall strategy in place, as well as sufficient insurance to cover any remaining risk of loss from this problem.
  - *Commodity price changes.* This can involve price increases from suppliers or price declines caused by sales of commodity items to customers. In either case, the CFO's options include the use of long-term fixed-price contracts, as well as a search for alternative materials (for suppliers) or cost cutting to retain margins in case prices to customers decline.
  - *Pollution.* Not only can a company be bankrupted by pollution-related lawsuits, but its officers can be found personally liable for them. Consequently, the CFO should be heavily involved in the investigation of all potential pollution issues at existing company facilities, while also making pollution testing a major part of all facility acquisition reviews. The CFO should also have a working knowledge of how all pollution-related legislation impacts the company.
  - *Foreign exchange risk.* Investments or customer payables can decline in value due to a drop in the value of foreign currencies. The CFO should know the size of foreign trading or investing activity, be aware of the size of potential losses, and adopt hedging tactics if the risk is sufficiently high to warrant incurring hedging costs.

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- *Adverse regulatory changes.* Changes in local, state, or federal laws—ranging from zoning to pollution controls and customs requirements—can hamstring corporate operations and even shut down a company. The CFO should be aware of pending legislation that could cause these changes, engage in lobbying efforts to keep them from occurring, and prepare the company for those changes most likely to occur.
- *Contract failures.* Contracts may have clauses that can be deleterious to a company, such as the obligation to order more parts than it needs, to make long-term payments at excessive rates, to be barred from competing in a certain industry, and so on. The CFO should verify the contents of all existing contracts, as well as examine all new ones, to ensure that the company is aware of these clauses and knows how to mitigate them.
- *System failures.* A company's infrastructure can be severely impacted by a variety of natural or man-made disasters, such as flooding, lightning, earthquakes, and wars. The CFO must be aware of these possibilities and have disaster recovery plans in place that are regularly practiced, so the organization has a means of recovery.
- *Succession failures.* Without an orderly progression of trained and experienced personnel in all key positions, a company can be impacted by the loss of key personnel. The CFO should have a succession planning system in place that identifies potential replacement personnel and grooms them for eventual promotion.
- *Employee practices.* Sometimes employees engage in sexual harassment, stealing assets, or other similar activities. The CFO should coordinate employee training and set up control systems that are designed to reduce the risk of their engaging in unacceptable activities that could lead to lawsuits against the company or the direct incurrence of losses.
- *Investment losses.* Placing funds in excessively high-risk investment vehicles can result in major investment losses. The CFO should devise an investment policy that limits investment options to those vehicles that provide an appropriate mix of liquidity, moderate return, and a low risk of loss (see Chapter 12, "Investing Excess Funds").
- *Interest rate increases.* If a company carries a large amount of debt whose interest rates vary with current market rates, then there is a risk that the company will be adversely impacted by sudden surges in interest rates. This risk can be reduced through a conversion to fixed interest-rate debt, as well as by refinancing to lower-rate debt whenever shifts in interest rates allow this to be done.
- *Link performance measures to strategy.* The CFO will likely inherit a companywide measurement system that is based on historical needs, rather than the requirements of its strategic direction. He or she should carefully prune out those measurements that are resulting in behavior not aligned with the strategic direction, add new ones that encourage working on strategic initiatives, and also link personal review systems to the new measurement system. This is a continuing effort, since strategy shifts will continually call for revisions to the measurement system.

- *Encourage efficiency improvements everywhere.* The CFO works with all department managers to find new ways to improve their operations. This can be done by benchmarking corporate operations against those of other companies, conducting financial analyses of internal operations, and using trade information about best practices. This task involves great communication skills to convince fellow managers to implement improvements, as well as the ability to shift funding into those areas needing it in order to enhance their efficiencies.
- *Clean up the accounting and finance functions.* Although most of the items in this list involve changes throughout the organization, the CFO must create an ongoing system of improvements within the accounting and finance functions—otherwise the managers of other departments will be less likely to listen to a CFO who cannot practice what he preaches. To do this, the CFO must focus on the following key goals:
  - *Staff improvements.* All improvement begins with the staff. The CFO can enhance the knowledge base of this group by tightly focusing training, cross-training between positions, and encouraging a high level of communication within the group.
  - *Process improvements.* Concentrate on improving both the accuracy of information that is released by the department as well as the speed with which it is released. This can be accomplished to some extent through the use of increased data-processing automation, as well as through the installation of more streamlined access to data by key users. There should also be a focus on designing controls that interfere with core corporate processes to the minimum extent possible while still providing an adequate level of control. Also, information should be provided through simple data-mining tools that allow users to directly manipulate information for their own uses.
  - *Organizational improvements.* Realign the staff into project-based teams that focus on a variety of process improvements. These teams are the primary implementers of process changes and should be tasked with the CFO's key improvement goals within the department.
- *Install shared services.* The CFO has considerable control over many administrative tasks, and so can encourage cost reductions in those areas through the use of shared services (where the same task is completed from a central location for multiple company locations). This can result in major cost savings, and is typically completed in coordination with the chief operating officer (COO), who might be responsible for some of the areas being consolidated.
- *Examine outsourcing possibilities.* A company should focus the attention of its management team on its core activity. The CFO can assist this effort by determining which noncore areas are absorbing large amounts of management time and/or funding, and seeing if they can be prudently outsourced. Though certainly not all noncore areas can be handled in this fashion, the CFO can conduct periodic reviews to see how the attractiveness of this option changes over time.
- *Allocate resources.* In its simplest form, the CFO is expected to review the net present value of proposed capital expenditures and pass judgment on whether funding should be allowed. However, the CFO can take a much more proactive stance. For

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example, he can set aside a block of cash for more radical projects that would not normally make it past the rigorous capital expenditure review process, thereby adding high-risk, high-return projects to the company's portfolio of capital projects. Under this approach, the CFO becomes an internal venture capitalist and mentor to the teams undertaking these high-risk projects.

- *Encourage innovation.* The CFO can modify internal measurement, reporting, and budgetary systems to ensure that some original ideas are allowed to percolate through the company, potentially resulting in the implementation of high-return ideas. It is particularly important to take this approach in mature businesses that are most highly concerned with cost reductions, since an excessive focus on this area can drive out innovation.

Most of the responsibilities noted here rarely fall entirely within the capabilities of the CFO. Instead, he or she must coordinate activities with other department managers, including such specialized areas as the legal and human resources departments, to ensure that these target areas are addressed. This calls for a strong ability to work with other members of the company who are probably not directly supervised by the CFO.

## OVERVIEW OF THE CHANGE MANAGEMENT PROCESS

Becoming the business partner that CEOs demand means facilitating change that not only affects finance but also directly impacts the operating units. To accomplish this end, CFOs must become skilled in the following key management practices:

- *Develop and communicate a compelling finance agenda.* Based on both their own perceptions of a company's situation and the recommendations of others, CFOs should create a list of bullet points for short-term and long-term accomplishments and memorize them so that they can repeat them to anyone at any time during the workday. Compressing the finance agenda in this manner is an excellent tool for communicating the CFO's work to others. Review the list regularly, and spread any changes to the list around the organization on a regular basis.
- *Build a commitment to change within the finance function.* Besides talking about the agenda to everyone in the company, CFOs must reinforce the message with their behavior, which means demonstrating a full commitment of the time and money required to make the agenda a reality. This also means that CFOs must be seen personally working on the agenda for a significant proportion of their time. Building staff commitment also means that CFOs must listen to staff views and let this shape their opinion of what should be included in the agenda.
- *Change executive management practices.* The director of strategic planning at a Fortune 500 company once pointed out that she spent 25 percent of her time determining the corporate direction, and 75 percent of her time convincing everyone in the organization that this was the right direction to follow. Though this sort of time distribution is extreme, CFOs must understand that many of the changes they advocate will impact other functional areas outside the accounting

and finance functions, and so will require a hefty allocation of time to communicate the change of vision. This requires regular meetings with managers throughout the organization, as well as employing strong listening skills to learn of any issues that might affect the implementation of the agenda. These meetings must be effective, requiring meeting agendas that are closely followed, have resultant minutes that identify who is responsible for the implementation of decisions reached, and a follow-up process to ensure that implementations are completed promptly.

- *Enlist the support of the CEO.* Work with the CEO to develop his or her role in creating and implementing the agenda. This requires frequent meetings to go over the agenda. In order to obtain the CEO's full support, it is most useful to ask the CEO to assist in jointly solving problems arising from the agenda implementation effort.
- *Mobilize the organization.* With the CEO firmly supporting the CFO's agenda, the rest of the organization must be mobilized to follow it as well. This calls for the creation of measurement and reward systems that are specifically designed to channel activities into the correct areas, plus visible and prolonged involvement by the senior management team and ongoing "communication events," such as general or team meetings, that describe the company's progress toward the completion of various items on the CFO's agenda.
- *Institutionalize continuous improvement.* Once the agenda has been achieved, CFOs should continue to review and question the functions of all systems to see if better ways can be found to operate the company. If so, and changes are made, then the CFO must alter the corporate measurement and reward system to ensure that the new initiatives are properly supported by the staff on an ongoing basis.

## DIFFERENCES BETWEEN THE CONTROLLER AND CFO POSITIONS

Having already discussed what the CFO position *should* do, it is also worthwhile to point out those areas in which the CFO should *not* become involved. This issue is of particular concern to controllers who have been promoted to the CFO position, but who are having difficulty relinquishing their old chores in order to take up new ones. The result is that, with twice the workload, the newly promoted CFO does both the CFO and controller jobs poorly. Exhibit 1.1 describes the tasks that are most commonly assigned to the CFO and controller.

The exhibit indicates that there are a few areas in which the two roles may become jointly involved in the accounting area. However, their levels of involvement are entirely different. For example, when external auditors review the company's accounting records, the CFO is most likely to maintain relations with the audit partner, and deal with any reportable audit issues uncovered. The controller, however, is more likely to be directly involved with the auditors in presenting the accounting books, explaining the reasons for specific accounting transactions, and providing labor for more menial tasks that the auditors would otherwise have to perform themselves.

The same issue arises in other accounting areas, such as the issuance of management reports, financial statements, or Securities and Exchange Commission (SEC)

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**EXHIBIT 1.1** Position Responsibilities

<b>Area of Responsibility</b>	<b>CFO</b>	<b>Controller</b>
<b>Accounting</b>		
Assist with the annual audit	X	X
Pay accounts payable on time		X
Collect accounts receivable		X
Take discounts on accounts payable		X
Issue billings promptly		X
Calculate job costs		X
Complete bank reconciliations		X
Issue management reports	X	X
Issue financial statements	X	X
File information with the SEC	X	X
Maintain policies and procedures		X
Maintain the chart of accounts		X
Manage outsourced functions		X
Manage the accounting staff		X
Manage the budgeting process	X	X
Review capital requests	X	
Process payroll		X
Implement operational best practices	X	X
Provide financial analysis	X	X
Develop performance measurements	X	
Maintain performance measurements		X
Review control weaknesses	X	X
<b>Finance</b>		
Formulate financial strategy	X	
Formulate tax strategy	X	
Formulate risk management strategy	X	
Negotiate acquisitions	X	
Maintain banking relations	X	
Arrange for debt financing	X	
Conduct equity placements	X	
Invest funds	X	
Invest pension funds	X	
Issue credit to customers		X
Maintain insurance coverage	X	
Monitor cash balances		X
Maintain investor relations	X	

reports. The controller creates the reports, but the CFO must review them before their release, since the CFO is the one who must explain their contents to readers. In the case of SEC reports, the CFO must personally certify them. The CFO also needs the information in order to see how the presented information fits into any other analyses being created; for example, if the CFO is building a case for an increased emphasis on product quality, a management report on material scrap trends would fit directly into this analysis.

The CFO and controller also have different roles in the budgeting process. The controller usually manages the nuts and bolts of obtaining information from other departments and incorporating it into a master budget. Meanwhile, the CFO is examining the data presented by the various departments to see how they have changed from the past year, how revenues and expenses reflect any changes in the company's strategic direction, and the reasons for capital expenditure requests.

A primary part of the CFO's job is to conduct financial analyses on various topics anywhere in the company, as well as to drive operational improvements, at least partially based on the results of the financial analyses. The CFO decides on which analyses to create and which improvements to push, while also presenting this information and proselytizing in favor of operational improvements with other department managers. Conversely, the controller is more likely to create the analyses mandated by the CFO and to implement improvements within the accounting function. Thus, there is a dual role for the CFO and controller in these areas, but on different levels.

Control systems also attract the attention of both positions. The CFO is extremely interested in controls, since any control problems reflect poorly on his or her performance. The controller is also interested, partially to spot problems for the CFO's attention, but mainly to ensure that the existing set of controls are functioning as planned. The CFO can be of particular assistance in setting up or changing controls impacting other departments, since the CFO is responsible for building relations between the accounting function and other areas of the company.

The finance area calls for minimal attention by the controller, who is only responsible for day-to-day activities in the areas of issuing credit and monitoring cash balances, which are simple activities that can easily be handled at the clerical level. In all other respects, financial activities involve a specialized knowledge of banking relationships, overall corporate strategy, and funds investment and procurement that falls directly within the CFO's area of expertise.

The main point to be gained from this comparison of the controller and CFO positions is that the controller is responsible primarily for the daily administration of accounting activities, whereas the CFO must cordon himself off from these activities and concentrate instead on the general design of control systems, strategic direction, and funding issues. Anyone who attempts to perform both jobs, except in a small company where a lack of funding usually calls for the merger of both positions, will be overwhelmed by the multitude of tasks to be completed. Realistically, someone who combines the positions will tend to concentrate on the daily activities of the controller and not attend to CFO tasks because of the perception that daily transactional activities *must* be completed, whereas strategic issues can always be addressed when there is spare time. Though this might work for a short interval, improper attention to the CFO part of

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the job will eventually lead to stagnation, inefficiency, and poor development of potential funding sources.

 **RELATIONSHIP OF THE CONTROLLER TO THE CFO**

In a larger company, there is a clear division of tasks between the controller and CFO. However, there is no clear delineation of these roles in a smaller company, because there is usually no CFO. As a company grows, it acquires a CFO, who must then wrestle away some of the controller's tasks that traditionally belong under the direct responsibility of the CFO. This transition can cause some conflict between the controller and CFO. In addition, the historical promotion path for the controller has traditionally been through the CFO position; when that position is already occupied, and is likely to stay that way, there can be some difficulty with the controller. This section discusses both of these issues.

In a small company, the controller usually handles all financial functions, such as setting up and maintaining lines of credit, managing cash, determining credit limits for customers, dealing with investors, handling pension plan investments, and maintaining insurance policies. These are the traditional tasks of the CFO, and when a company grows to the point of needing one, the CFO will want to take them over from the controller. This can turn into a power struggle, though a short-lived one, because the controller always reports to the CFO and will not last long if there is no cooperation. Nonetheless, this is a difficult situation, for the controller has essentially taken a step down in the organizational structure upon the arrival of the CFO. For example, the CFO replaces the controller on the executive committee. If the controller is ambitious, this will probably lead to that person's departure in the near term. If the controller is good, this is a severe loss, for someone with a detailed knowledge of a company's processes and operating structure is extremely difficult to replace.

The controller should take a job elsewhere if he or she perceives that the person newly filling the CFO position is a roadblock to further advancement. However, this does not have to be a dead-end position. The controller should talk to the CFO about career prospects within the company and suggest that other responsibilities could replace those being switched to the CFO. For example, a small minority of controllers supervise the materials management department; this will become increasingly common as controllers realize that much of the paperwork they depend on originates in that area and that they can acquire better control over their processes by gaining experience in this area. There might also be possibilities in administration, human resources, and computer services, which are sometimes run by controllers. The fact that there is a new CFO does not mean that a controller should immediately quit; other opportunities involving related tasks could shift the controller's career in other directions.

The CFO position is one with an extreme emphasis on money management, involving such tasks as determining the proper investment vehicles for excess cash, dealing with lenders regarding various kinds of debt, making presentations to financial analysts, and talking to investors. None of these tasks is one that the controller is trained to perform. Instead, the traditional controller training involves handling transactions,

creating financial statements, and examining processes. The requirements for the CFO position and the training for the CFO position are so different that it seems strange for the controller to be expected to advance to the CFO position, and yet that is a common expectation among accountants, which regularly causes problems between the controller and CFO when a CFO is initially hired.

## OTHER DIRECT REPORTS: THE TREASURER

The treasurer is accountable for corporate liquidity, investments, and risk management related to the company's financial activities. The treasurer usually reports to the CFO and is positioned in the corporate hierarchy alongside the controller. The treasurer has 12 principal accountabilities:

1. Forecast cash-flow positions, related borrowing needs, and available funds for investment.
2. Ensure that sufficient funds are available to meet ongoing operational and capital investment requirements.
3. Use hedging to mitigate financial risks related to the interest rates on the company's borrowings, as well as on its foreign exchange positions.
4. Maintain banking relationships.
5. Maintain credit rating agency relationships.
6. Arrange for equity and debt financing.
7. Invest funds.
8. Invest pension funds.
9. Monitor the activities of third parties handling outsourced treasury functions on behalf of the company.
10. Advise management on the liquidity aspects of its short- and long-range planning.
11. Oversee the extension of credit to customers.
12. Maintain a system of policies and procedures that imposes an adequate level of control over treasury activities.

## OTHER DIRECT REPORTS: THE INVESTOR RELATIONS OFFICER

The investor relations officer (IRO) is accountable for creating and presenting a consistently applied investment message to the investment community on behalf of the company. The IRO also monitors and presents to management the opinions of the investment community regarding the company's performance. The IRO may report directly to the chief executive officer, but also commonly reports to the CFO, since the IRO deals with primarily financial information. The IRO has 16 principal accountabilities:

1. Develop and maintain a company investor relations plan.
2. Perform a comprehensive competitive analysis, including financial metrics and differentiation.

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3. Develop and monitor performance metrics for the investor relations function.
4. Establish the optimum type and mix of shareholders and create that mix through a variety of targeting initiatives.
5. Monitor operational changes through ongoing contacts with company management and develop investor relations messages based on these changes.
6. Provide Regulation Fair Disclosure training to all company spokespersons.
7. Create presentations, press releases, and other communication materials for earnings releases, industry events, and presentations to analysts, brokers, and investors.
8. Oversee the production of all annual reports, SEC filings, and proxy statements.
9. Manage the investor relations portion of the company Web site.
10. Monitor analyst reports and summarize them for senior management.
11. Serve as the key point of contact for the investment community.
12. Establish and maintain relationships with stock exchange representatives.
13. Organize conferences, road shows, earnings conference calls, and investor meetings.
14. Provide feedback to management regarding the investment community's perception of the company.
15. Represent the views of the investor community to the management team in the development of corporate strategy.
16. Provide feedback to the management team regarding the impact of stock repurchase programs or dividend changes on the investment community.

### SUMMARY

It should have become apparent in this chapter that the key attributes of the CFO do not lie in the area of accounting competency. If a CEO wanted skills in that area, the CEO would hire a great controller and never fill the CFO position. Instead, the key CFO attributes are that person's ability to find innovative ways to solve problems, and then to use change management skills to implement them. By focusing on these key areas, the CFO brings the greatest positive impact to overall corporate value.

In addition, the CFO must concentrate a great deal of his time on the formulation and implementation of appropriate strategies in the areas of accounting, taxation, and (if responsible for this area) information technology. These issues are addressed in Chapter 2, "Financial Strategy"; Chapter 3, "Tax Strategy"; and Chapter 4, "Information Technology Strategy."