
THE CFO BALANCING ACT: FROM BUSINESS ADVISOR TO FINANCIAL LEADER

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Executive Summary

The New Role of the CFO

The topic of the inaugural meeting of The CFO Alliance was the New Role of the CFO and how the pressures of a new global business climate have affected the role and responsibilities of the CFO. Today's economy has created more of a demand for CFOs to work across business lines in areas that, traditionally, they have had little to do with (for example, technology integration and human resources).

The role of the CFO continues to grow and evolve as technology and the world change. Earlier generations of CFOs were report-driven professionals focused on accounting compliance. They had high IQs but low Emotional Intelligence and weak interpersonal skills.

Today's CFOs are still responsible for the financial mission of the organization, but they are stronger in technology and leadership skills. Traditionally, they are the intermediaries between the financial markets and real assets/financing and make investment decisions for their companies. They develop processes and reports to control costs. The role of the CFO remains that of the corporate officer who mitigates risk, identifying a cash flow risk profile. He or she manages the operating, financial, exchange rate risk and enterprise wide risk for the company; degree of financial leverage; operating leverage and total leverage.

The new generation of CFO, however, creates value for the organization acting as an integrator of business activities and assets. He or she is a strategist creating sustainable value for the company's shareholders. The CFO generates productivity strategy by improving costs structure; increasing asset utilization; managing capacity; and making incremental investments. He or she fosters growth strategy through the expansion of revenue opportunities by means of new products and markets and improving the profitability of existing customers.

The Traditional CFO Role:

- ◇ The traditional view- accounting based/ financing and investments and dividends
- ◇ Transparency and trust are important
- ◇ Comprehensiveness vs. simplicity
 - Comprehensiveness == evaluate alternatives/estimate cost of capital, assess taxes, identify depreciation /and estimate forecasted cash flow
 - Simplicity == make bold assumptions/develop ranges and estimate available investment returns
- ◇ Costs vs. benefits
- ◇ Process orientation vs. chaotic structure/ sequential thinking creates a mentality of incremental minimum returns.
 - Chaotic orientation – adding a shock / upset / bold initiative adopting more risks than average can generate more profitability.
- ◇ Manage and support strategic opportunities to take advantage of chaotic conflicting options

The CFO as a Strategic Leader:

An evolutionary process no a revolutionary process

- ◇ The drive to simplicity is leading the change in structure and process – reduce business complexity; shared services and outsourcing
- ◇ Drive to improve technology ROI- access to technology – make or buy decisions
- ◇ Reconcile what customers value and what creates value for shareholders
- ◇ Major reorientation- linking customer value, shareholder value and intangibles
- ◇ Smaller, better outfit/ eliminate manual activities/be strategic/lots of manual controls

Valuation of Real Options

Today's CFOs have access to valuable financial tools to aid them in their new roles; one in particular, is the Valuation of Real Options. "Real Options is an important way of thinking about valuation and strategic decision-making, and the power of this approach is starting to change the economic 'equation' of many industries,"¹ The Valuation of Real Options, once "identified and specified"² can be used to value uncertainty in the decision-making process – capital budgeting – and are tools that are more relevant today because of the uncertainty that is inherent in a global economy.

When the concept was first introduced, Real Options might not have been given a chance to work because it focused on the technical aspects of modeling, not as a way of thinking as it is today. The theory works because an option is the right, but not the obligation, to take an action in the future. This drives value when there is uncertainty. The Real Options approach provides a construct to help CFOs manage enterprise-wide risk exposure by better quantifying and forecasting individual level project risk and value factors. The approach also helps CFOs to uncover potential value drivers, which further enhance strategic planning initiatives.

Examples of Real Options | Innovation and creativity in thinking about uncertainty

'There is a great future in uncertainty- uncertainty creates opportunity.'

- ◇ Waiting-to-Invest options: i.e. technology uncertainty
- ◇ Growth Options: i.e. expansion to Chile
- ◇ Flexibility Option: i.e. two markets/two different risks
- ◇ Exit and Reversibility Options: i.e. the value of abandoning an investment opportunity

Case Study Feedback:

Dean Tsetsekos presented the participants with a case study, "Finance: The Business Integrator at Microsoft."¹ This case highlighted a practical application of how the role of the CFO has changed and discussed the approach Microsoft took to change their Financial Processes in order to better adapt to the changing market they were encountering. The point of asking the CFOs to read this case was to bring attention to the business management functions of today's CFO and spark conversation among the group.

Participants provided feedback from their individual group discussions with varying points of view and a few common threads:

- ◇ IT was the most common issue brought up by the CFOs. The concern was based on its integration and relevance to the CFOs in the future.
- ◇ The 'synthesization' of information was also continually mentioned as to how information from all functions, HR, IT, needs to be gathered and delivered in a quantitative fashion.
- ◇ The groups also thought the simplification of communication was an important factor.
- ◇ The fourth common theme was stewardship. The CFOs felt that the function is still relevant but they wondered how to define and deal with it.
- ◇ Lastly, the CFOs said that they needed to be considerate of risk. They felt that it was within their duties to bring "realism" into the picture when discussing strategic decisions.



1. *Real Options, Managing Strategic Investment in an Uncertain World*, Martha Martha Amram and Nalin Kulatilaka, Harvard Business School Press, 1999, *Introduction to Real Options* P.3

2. *The CFO as Business Integrator*, Cedric Read, Hans-Dieter Scheuermann and the mySAP Financials Team, John Wiley & Sons LTD, 2003, *Best Practices in Finance: Who's Next?* Pp. 12-14

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