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Activists At The Gate

Activist investors are on the prowl. Here's how to keep them at bay

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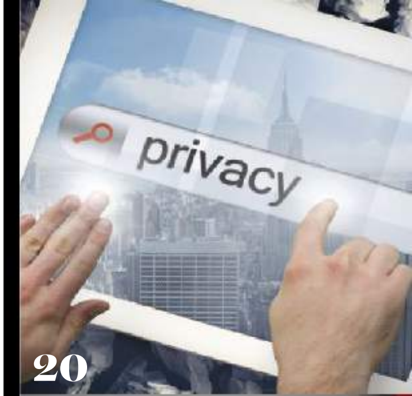

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By the Numbers

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FROM THE EDITOR

Activists And Hackers

››CFOs, beware: Activist hedge funds are on the prowl. Impatient value investors, activists like nothing better than a solid but underperforming company to target. And institutional investors are increasingly lining up behind them, as we report in our cover story, **"Activists at the Gate"** (page 30). The best way to stave off an activist challenge, experts tell *CFO,* is to beat them to the punch, by critically reviewing your strategy, operations, and results; building a solid, competent board; and regularly meeting with large shareholders. By doing, in short, what good companies already do.

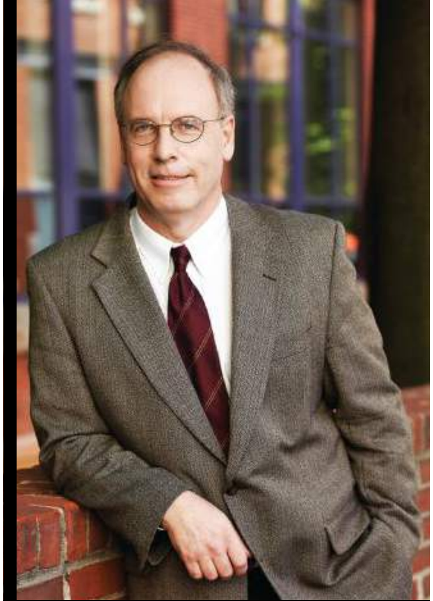
Elsewhere in this issue, cybersecurity is a recurring theme. For starters, the CFO of Proofpoint, a cybersecurity firm, explains why his firm is teaming up with a firewall company to combat cyber threats. No single way of fighting online attacks is sufficient, says Paul Auvil in **"Proofpoint CFO: No Phishing Allowed"** (page 16).

Next, contributor John Parkinson reports that companies in the European Union will have to change how they handle consumers' online data if and when the General Data Protection Regulation framework of consumer data privacy is ratified by the EU states. Speaking as a former chief technology officer, Parkinson explains why complying with the GDPR will be a major headache in **"The Cost of Privacy"** (page 20).

The topic of shared security resumes in our special report on cybersecurity, **"Share and Share Alike"** (page 40). David M. Katz tells how the recently enacted Cybersecurity Information Sharing Act of 2015 will allow companies to share information about cyber threats with other companies and the government—but only if the information is properly scrubbed of personal information. That could pose a challenge, attorneys warn.

Finally, in **"The Digital CFO"** (page 36) Chris Schmidt discusses the findings of a survey by CFO Research on how information technology, both business and personal, is reshaping the roles of finance chiefs. Most CFOs report that they stay current with advances in IT, but only 8% of respondents would describe themselves as "geeks."

Edward Teach
Editor-in-Chief



EDITOR'S PICKS

MANAGEMENT

The latest *McKinsey Quarterly* features a wake-up call on sleep deprivation, "The Organizational Cost of Insufficient Sleep." After reviewing the link between effective leadership and adequate sleep, the authors describe how companies can promote healthy sleep habits. To read this eye-opening article, go to http://www.mckinsey.com/business-functions/organization/our-insights/the-organizational-cost-of-insufficient-sleep.

LEADERSHIP

CFO's Corporate Performance Management Summit will be held in San Diego on June 8–9. The theme is "Driving corporate performance through financial initiatives." For more information, go to https://theinnovationenterprise.com/summits/corporate-performance-management-summit-san-diego-2016.

Kory Addis

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In his provocatively titled article **"Companies Should Stop Paying Sales Commissions"** (Feb. 12), contributor Justin Roff-Marsh wrote that he wishes he had a dollar for each time an incredulous executive has asked him why salespeople would sell if they didn't earn commission.

If granted that wish, Roff-Marsh's own income would get a boost, based just on reactions from CFO.com's audience.

Roff-Marsh, a sales and marketing consultant, argued that salespeople on straight salary would still sell because it's their job, just as people in other salaried positions do their jobs. He advocated shifting salespeople to a salary that's slightly greater than their average total earnings over some prior period, concluding that "the *potential* to earn a certain amount of money is not worth nearly as much as the same figure, *guaranteed*."

Let's just say that readers were not sold on his reasoning.

"The commentary in this article is incredibly naive," one wrote. "Salespeople have a completely different personality than an AP clerk or receptionist. Comparing them is ludicrous." And: **"If a salesperson isn't motivated by commission, then that person isn't a good fit for sales."**

Another commenter got a bit more personal with the author. "I have to ask, why did you start your own business? **If you believe what you wrote, then why not give away all of the money your business has made above and beyond your last salaried position? …** Good salespeople will not continue to produce big results that require greater efforts/skills if the reward is the same as any job providing 3% raises and [requiring] average effort. That is a recipe for mediocrity."

THE BUZZ ON CFO.COM

One audience member did allow that he could agree with Roff-Marsh, "as long as the company is … holding employees accountable to performance, mentoring the middle 60–70%, and discharging the bottom 10–20%."

That comment didn't sit well with another reader. "If you are hiring great people, there is no need to discharge anyone annually," she wrote. Also: "If you are chopping 15% each year, **even the most skilled salesperson could have a bad year** due to a change in the health of their account [portfolios]." And: **"Territories and accounts are never created equal, and sometimes the top producers are those with better account portfolios."**

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STATS OF THE MONTH

PROFIT SQUEEZE

0.4%
Year-over-year change in 2015 pro-forma, per-share earnings for S&P 500 companies

-12.7%
Year-over-year change in 2015 GAAP per-share earnings, S&P 500 companies

-4.55%
Estimated decline in fourth-quarter earnings for S&P 500 companies, 2015 vs. 2014

78
Number of S&P 500 companies that have issued negative EPS guidance for Q1 2016*

* As of February 23.
Sources: Factset, S&P Capital IQ

Topline

LAW

Deadlocked Court May Tie Up Class Actions

Until a replacement for Justice Scalia is named, the Supreme Court may be unable to reach decisions in key business cases.

The fate of a number of significant Supreme Court class actions is up in the air following the death of Justice Antonin Scalia in February.

The case with perhaps the greatest potential impact on companies is *Tyson Foods, Inc.* v. *Bouaphakeo*. Employees in an Iowa slaughterhouse sued Tyson for allegedly not keeping complete records of overtime hours worked, thereby shorting them on overtime pay.

The case is a test of whether the Court can approve a Rule 23 class action, in which damage claims are determined by statistical modeling rather than each class member's individual damages. Statistical modeling makes it easier and less expensive for plaintiffs to bring class actions against companies and easier to win a judgment.

Many court observers had believed that the case would be decided 5–4 in favor of banning Rule 23 case approvals. Without Scalia's presumed vote with the majority, the vote could be 4–4, and a tie vote is tantamount to the court not making any ruling at all.

The Court may opt to decide the case based on the narrower issue of what proof is needed to support claims related to overtime pay, says Evan Young, a partner in the Austin, Tex., office of law firm Baker Botts. But that doesn't mean the court won't eventually decide the bigger issue relating to Rule 23 class actions.

"It's not really in anyone's interest to resolve cases 4–4, because it's usually only another year or two until the next case comes along that squarely presents the issue and there's no dodge available," says Young, who clerked for Scalia in 2005 and 2006.

The Supreme Court also can decide to hold on to deadlocked cases until a ninth justice is seated.

Another class action with significant potential ramifications for companies is *Spokeo, Inc.* v. *Robins*. The case involves the Fair Credit Reporting Act (FCRA), which is frequently the subject of class actions.

Spokeo is a people-search website that aggregates data from online and offline sources; companies often use it to evaluate job candidates or people involved in potential transactions. In the case, the plaintiff, Thomas Robins, claims Spokeo published inaccurate information about him. The question before the court is whether Robins and others like him are entitled to bring a lawsuit claiming damages, even if they suffered no actual harm, when a company does not adhere to the letter of a law (in this case, the FCRA).

"The Constitution says, as the Supreme Court has understood it, that for a private person to bring a lawsuit, he or she has to have an actual injury," says Young. The Ninth Circuit Court of Appeals had ruled that it's not harmful for a person to be portrayed as more educated than he is or as earning more money than he does, Young notes.

Young says that with Scalia, the case very likely would have been decided 5–4 against the plaintiffs. He notes that the case is relevant to many companies, not just credit reporting agencies, and that such actions can cost companies a lot of money. For example, FCRA violations can result in a company being fined up to $1,000 per credit application.

However, the Supreme Court may rule not on the substance of the case but on whether it is proper for the court to hear it at all.

One area of law may actually be interpreted more conservatively in the future, depending on Scalia's replacement, says Young. The late jurist consistently held that the Supreme Court has no authority to review punitive damages awarded by lower courts. In so doing, both he and Justice Anthony Kennedy typically sided with the Court's more liberal members. "In this area of the law that matters greatly to businesses, Scalia brought the Court to the left and was the best friend of plaintiffs' lawyers," Young says.

DAVID McCANN

THE ECONOMY

Retail CFOs: Down, but Not Out

CFOs of retail companies have fairly tepid views on business prospects for 2016, following a poor year that was capped by disappointing holiday-season sales.

Among 100 retailer finance chiefs polled by BDO, three quarters say they expect sales to increase this year, but on average they peg the increase at only 3.4%. That's down from 3.9% in last year's annual survey of such CFOs by the auditing and advisory firm, and 5.1% the year before that.

"That 3.4% is not a very strong outlook," says Doug Hart, a partner in BDO's consumer business practice. Historically—meaning, before the 2009-2010 recession—such forecasts routinely topped 4%, he notes.

Of course, forecasts and actual results often don't match up. For example, despite the 3.9% sales gain that retail CFOs in BDO's survey had predicted for 2015, actual growth turned out to be 2.1%, according to the Commerce Department. It was the poorest year-over-year performance since the sharp decline suffered in 2009.

BDO's survey was taken just after New Year, when global markets were plunging. That probably influenced the relatively gloomy expectations. "We've seen an increasing correlation between stock market performance and consumer confidence," Hart says.

Only 28% of the surveyed CFOs say they expect consumer confidence to increase this year, compared with 54% who said so a year ago about 2015.

Also dampening retail CFOs' moods, holiday sales increases significantly trailed forecasts. With mall traffic down, sales in brick-and-mortar stores were flat during the holidays, and a bump-up for e-commerce and mobile commerce wasn't strong enough to compensate for it, Hart notes.

Further, the current low price of gasoline has not spurred retail sales as much as had been hoped, and more of the same is expected for this year.

Still, retail CFOs are hardly are in a panic that the "sky is falling," says Hart.

"They've been through their budgeting and planning season [for 2016], and they're not going to have a knee-jerk reaction just because holiday sales were a bit off plan and there's global market turbulence," he says. "They're still looking to the long term, and there's a lot that can happen between now and next fall and the holiday season."

In the short term, CFOs will adjust their capital expenditures and buying patterns to accommodate expected softness in sales. "Does that mean retail CFOs believe we're headed toward a recession? No," says Hart. On the other hand, "Does it look like consumers are going to bail out the rest of the economy? No. If it's up to consumers, we're probably going to have slow, modest growth." **D.M.**

Top 2016 Risks for Retail CFOs

Competition and consolidation in the retail sector	29%
Federal, state, and/or local regulations	21%
Geopolitical events/ natural disasters	20%
Protection of customer data from potential breach	15%
U.S. and foreign supplier concerns	8%
Excess inventory	8%

Source: BDO

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EARNINGS

Airlines Moderate Profit Outlook

Airline chief financial officers and heads of cargo have lowered their profit expectations for 2016, probably reflecting concerns over weakness in the global business environment and emerging market economies, according to the International Air Transport Association.

"The rate of expected improvement in profitability over the next 12 months has fallen over the past two quarters, suggesting that improvements in key drivers might have peaked earlier in 2015," IATA said in its quarterly survey.

More than 45% of respondents predict improved profitability over the next year, while 25.7% expect a decrease and 28.6% see no change. Recent gains in profitability have been driven by strong passenger growth and lower oil prices.

Paul Jacobson, finance chief of Delta, told *CFO:* "Airlines' revenue performance was a bit disappointing in 2015 versus expectations heading into the year. For the industry it could have been better. But when you sit in my seat and have a healthy respect for the history of the airline business, it's performing really well right now."

IATA says passenger traffic volumes were up during the fourth quarter of 2015 compared with the year-ago period.

"The survey results are consistent with the latest air transport data, which indicate that air travel is up 6-7% compared with a year ago," the association said. "Despite weakness in some emerging market economies, passenger air travel continues to expand strongly, supported by declines in the real cost of air transport."

Respondents also said airline employment activity increased in the fourth quarter and that they expect a small amount of growth in headcount in the year ahead.

KATIE KUEHNER-HEBERT

COMPENSATION

Merit Pay Unrewarding

A surprisingly large number of North American employers say their merit programs aren't an effective way of driving and rewarding employee performance, according to a new survey.

The consulting firm Willis Towers Watson reports that only 20% of North American companies find merit pay to be effective at driving higher levels of individual performance at their organization. In addition, only 32% say their merit pay program is effective at differentiating pay based on individual performance.

"Employers continue to make significant investments of time and money in their traditional pay-for-performance programs, primarily annual merit pay increases and annual incentives," Laura Sejen, global practice leader for rewards at Willis Towers Watson, said in a news release. "Unfortunately, these reward programs are falling short in the eyes of many employers."

Employers also give their short-term annual incentive programs low marks. Only half say these programs are effective at boosting individual performance levels, and even fewer (47%) say annual incentives effectively differentiate pay based on how well employees perform.

Willis Towers Watson noted that some changes are underway, with organizations reporting their managers are adopting a broader, more forward-looking view of performance when making decisions about merit pay.

While 64% of survey respondents said managers at their organization consider demonstration of knowledge and skills required in an employee's current role when making merit increase decisions, 46% said their programs are designed to take these performance indicators into consideration.

"Pay-for-performance programs, when designed and implemented effectively, are great tools to drive performance, and recognize and reward employees," Sejen said. "However, conventional thinking on pay for performance is no longer appropriate. Companies need to define what performance means for their organization and how managers can ensure they are driving the right performance, and re-evaluate the objectives of their reward programs to ensure they are aligned with that definition."

MATTHEW HELLER

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CREDIT

Liquidity Woes Spread

A measure of stress in the junk bond market reached a six-year high in January as liquidity weakness started to spread beyond the energy industry, according to Moody's Investors Service.

The rating agency says its Liquidity Stress Index (LSI) jumped to 7.9% in January from 6.8% in December 2015, the highest since December 2009 and the biggest one-month gain since March 2009.

The energy sector continues to be the main driver of liquidity weakness, with the LSI for oil and gas increasing to 21.4% in January from 19.6% in December, just slightly below its 24.5% recessionary peak in March 2009. But Moody's notes that some companies in other sectors are beginning to face liquidity challenges.

The LSI excluding the oil and gas sector jumped to 4.5% in January, the highest level since November 2010.

Companies in the oil and gas and mining sectors have issued nearly $2 trillion in bonds globally since 2010, many of them in the junk category. With low oil prices continuing to pummel the energy industry, Moody's warned last month that companies in the sector are facing a spike in defaults and downgrades, while investors in their debt are looking at major losses.

Six of the 10 downgrades to Moody's weakest liquidity rating, SGL-4, in January were outside of energy, although they included two suppliers to commodity companies, GrafTech International and Fairmount Santrol, which were lowered because of their exposure to the steel and oil and gas sectors, respectively.

The other non-energy downgrades to SGL-4 were 99 Cents Only Stores, Postmedia Network, Spanish Broadcasting System, and Noranda Aluminum Acquisition.

"Operating weakness and maturities coming due in early 2017 are straining the liquidity of companies of some low-rated companies," John Puchalla, a Moody's senior vice president, says in a news release. "As borrowing rates rise and credit markets tighten, companies closer to the margin will find it challenging to cost-effectively refinance their upcoming debt maturities." **M.H.**

M&A

Twice as Many Firms Plan Asset Sales

Significantly more companies plan to divest assets to recommit to core businesses or fund innovations to keep up with consumer preferences, according to EY's 2016 Global Corporate Divestment Study.

Roughly half (49%) of the corporate and private equity executives surveyed by EY are planning to divest within the next two years, compared with just 20% who said so in last year's survey. Only 5% of companies do not expect to make any divestments in the next two years, compared with 56% in 2015.

More than two-thirds (70%) say they plan to use the proceeds from divestments to grow their core business, invest in new products and markets, and acquire a complementary business. Among companies that completed a divestment last year, 39% re-invested funds back into the core business; 20% invested in new products, markets, or geographies; and 11% made an acquisition.

"Divestments are a strategic route to generate long-term growth," Pip McCrostie, EY's global vice chair for transaction advisory services, says. "They are increasingly being used to fund new opportunities, to stay ahead of changes in consumer preferences and to drive innovation."

Companies that used their last divestment to fund an acquisition were 62% more likely to have experienced a higher-than-expected valuation multiple on the remaining business post-sale than a company that used the funds to pay down debt, according to the survey.

For companies that divested 10% of their enterprise value, their stock prices outperformed the public index by 612 basis points more than they did in the one-year period pre-sale. For those that divested 20% of their enterprise value, their stock prices outperformed the previous year by 1,104 basis points.

"With markets rewarding divestments that represent bold portfolio decisions and strong strategic rationale, all signs point to a strong 2016," says Paul Hammes, EY's global divestiture advisory services leader. "That said, maximizing the value of a divestment is firmly rooted in having an in-depth understanding of the business's value. Too often, sellers leave money on the table, particularly when enticed by unsolicited offers." **K.K.H.**

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cpsi	Trilogy Health Services, LLC	JW Aluminum
$175,000,000	**$300,000,000**	**$90,000,000**
Senior Secured Credit Facilities	Senior Secured Credit Facility	Senior Secured Credit Facility
Joint Lead Arranger and Book Manager*	Co-Lead Arranger and Bookrunner*	Sole Lead Arranger and Bookrunner*
January 2016	**December 2015**	**December 2015**

Martin Resource Management	ml MarketLab	Round Table Pizza
$355,000,000	**$67,000,000**	**$34,000,000**
Senior Unsecured Credit Facilities	Senior Secured Credit Facilities	Senior Secured Credit Facilities
Joint Lead Arranger and Sole Bookrunner*	Joint Lead Arranger and Bookrunner*	Sole Lead Arranger and Book Manager*
November 2015	**November 2015**	**November 2015**

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Proofpoint CFO: No Phishing Allowed

A finance chief brings his engineering background to bear on "spear phishing" and other cybersecurity risks. By David M. Katz

In the view of Paul Auvil, the CFO of Proofpoint, a cybersecurity firm, no single way of fighting online attacks against companies is infallible. Hence, on January 20, the company announced that it had formed a partnership with Palo Alto Networks, which builds firewalls to defend clients against cybercrime.

Before the agreement, Proofpoint was a "security-as-a-service" cloud and on-premises vendor focused exclusively on sifting through corporate emails to nab hackers. Thus, "we knew all sorts of interesting things about email that [Palo Alto didn't] because they're within the network world as a firewall," he adds.

"But they know all sorts of things about the network that we don't know. And so by sharing their network intelligence and our email intelligence, together we both can be more effective," Auvil says. "We very much think that this is the likely paradigm that will evolve over time" in cybersecurity technology.

Auvil speaks with technical savvy about cybersecurity because he possesses something very rare among finance chiefs: an engineering background. His tech education and experience is hefty enough to have enabled him to hold patents in digital video compression in Japan and in a high-speed, on-chip payment card connection system in the United States.

Last month, Auvil spoke at length about cybersecurity and how his career path shifted from technology to corporate finance. An edited version of that conversation follows.

How will Proofpoint and Palo Alto team up to curb cyber attacks at your corporate clients?
A classic example would be a spear-phishing attack. Let's say potential attackers have gone to a social media website and figured out who the vice president of finance is at a particular customer. Then they send an email with a link that looks like it's going to a completely legitimate website. Now in fact that website is infected with malware, and if the target were to click on it, that would end up in a bad outcome for the company and the individual who received and responded to that email.

Proofpoint has a system that looks for those spear-phishing attacks in emails and blocks them. Separately, Palo Alto Networks has a system that looks for links from bad websites and tries to block them before they get into the client's network. But neither of our products is infallible, so while we might let it through, they could catch it, or vice versa. It improves the blocking rate of nefarious content. You need a combination of knowledge about the email sender and about the network URL link to effectively identify and block an attack.

As a cybersecurity company, how do you handle your own data security?
We use our own products because we think they're quite good. And we use a variety of other world-class solutions from vendors across the security landscape for our firewall infrastructure and our capabilities in and around end-point security. We're like any other company in that we've got our own set of capabilities. But one thing that may be different is that we have an army of engineers who are security experts. And we have a pretty meaningful advantage over the average company in that we have a bunch of people who worry about the security of our company every day, because if we were to be compromised that would have an impact on our brand. These people do that every day in addition to their regular jobs.

What assets are you most focused on protecting?
In our case the most important thing to protect is our customers' confidential information. We do business with financial services companies and health care companies, and there are all sorts of very important information related to their customers and clients

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that have to be protected. We need to protect that first and foremost. And then we want to protect our employees' confidential information, their Social Security numbers, and payroll records. Of course, we have $400 million in the bank [i.e., in total cash holdings] that we would really rather not get wired off to somewhere in Russia where we can't get it back.

As the CFO, what are your security responsibilities?
The IT organization works for me, so I'm responsible for putting in place and maintaining the security infrastructure. I have a head of IT, and he and his team are constantly looking at the nature of the ways that we could be attacked and how to try to remediate that. I have a unique background because I started life as an engineer, so I have a technical understanding of how the infrastructure works—how all these systems work together. As a result I work collaboratively both with the head of IT and the security experts on our engineering team.

Do you see yourself as a liaison between tech and the board on internal cybersecurity issues?
That is certainly part of my role. Having worked as an engineer and had patents, I have a granular understanding of the technology. When dealing with members of the audit committee, I help them understand in lay person's terms what we are doing, why we are doing it, what we should be thinking about, and what other questions they should be asking.

How does your perspective shift when you talk to your tech team about their design of Proofpoint's products, rather than internal security?
A lot of my time spent with the engineering teams is listening and understanding technically what they're doing and where they're going with the product line. My input is about doing this in the most cost-efficient manner possible. We want to deliver a high-quality service that involves a process of inventing and reinventing. But we want to do it in a way that we can hit the price points we need to deliver profitability and cash flow to shareholders.

Engineering's an unusual background for a CFO. Describe your career path.
I graduated from Dartmouth with a degree in electrical engineering and went to work for Sony in Japan for a year as an engineer in their digital television labs. Back in 1985, that really was rocket science, because TVs were analog. The idea of digitizing the TV signal was a big deal. It was the early generations of what ultimately became HDTV. And so I filed patents as part of the team there and received a number of patents for the work that I did.

But part of what I ultimately came to realize is that while I really liked engineering, starting life as a beginning engineer meant that it would be a long time before I could have a significant impact on a company. And I always had aspirations to play a role in helping to build a big technology franchise. The other thing I realized is that there were a lot of engineers that were a heck of a lot better than me. I could probably be an above-average but not exceptional engineer.

"Having worked as an engineer and had patents, I have a granular understanding of the technology."

›› Paul Auvil, CFO, Proofpoint

So I went back to study marketing at the Kellogg Graduate School of Management at Northwestern University. But when I graduated in 1988, other than maybe Microsoft and Apple, nobody understood what marketing was in technology, and I couldn't find a decent marketing job. But Ken Goldman [the current CFO of Yahoo], who at the time was at a chip company called VLSI Technology, was looking to hire some MBAs to help him build the finance team. Within the first year and a half, I realized that the combination of a technical background working in a technology company along with my quantitative skills and focus on finance was a unique combination.

With Gary Steele [the chief executive officer] here at Proofpoint, it's the same thing. Gary wanted somebody who really understood and appreciated the technology, especially because we were building out in the cloud, which he'd never done before. Quite frankly, I'd never done it before either. The question was: How do we take this complex technology and put it in the cloud—and do it in a way where we can hit price points that make sense for our customers. CFO

Editor's Choice

GOING ON THE OFFENSIVE
U.S. government agencies spent more than $14.5 billion on IT security in 2015, according to estimates cited in a Deloitte cybersecurity report. The worldwide financial services industry spent $27.4 billion on information security and fraud prevention. Companies are "going on the offensive," according to the report.

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The Cost of Privacy

The EU's new General Data Protection Regulation will force companies to change how they handle consumers' online data. By John Parkinson

Figuring out who owns or can work with the "information exhaust" of an individual consumer's online activity has always been something of a challenge. On the one hand, there are many opportunities to look for patterns in this data and make helpful suggestions or predict future actions and position to create a commercial advantage. On the other hand, it's easy to deliberately or inadvertently go beyond what's generally considered to be acceptable behavior and trespass on an individual's personal and economic footprint—in other words, to invade their privacy.

The more we move everyday life online, the more urgent it becomes to get some workable ground rules established. Today's combination of opt in unless you explicitly opt out (and who reads all that fine print anyway) is common in the United States and some other jurisdictions. But it isn't really working.

"Do not track" functions and ad blockers can help but are often turned off by default and can be confusing to use effectively. The ability to securely manage all the data that's being collected continues to be an issue. We clearly need everyone involved (including the consumer) to work together to get this under control before it gets out of control.

To make matters worse, there is probably $80 billion or more of online advertising spend and additional, uncounted, billions of data collection and predictive analytics services revenues tied up in these un- or under-regulated processes.

In the European Union, all that's about to change. After several decades of disharmonious national policies and laws, the EU has agreed to a common "framework"—the General Data Protection Regulation, or GPDR. This framework for consumer data privacy is supposed to be implemented by all member states (assuming it gets ratified by the member states—likely but not guaranteed) by 2018.

Under this framework, member states can still have local additions to the rules, but must implement a set of common regulations founded on a set of principles, originally enshrined in EU Directive 94/46/EC (that, as a directive, provided guidance only) which the regulation is intended to strengthen and effectively replace. The original directive provided for the following:

- Notice: Subjects whose data are being collected should be given notice of such collection.
- Purpose: Data collected should be used only for stated purpose(s) and for no other purposes.
- Consent: Personal data should not be disclosed or shared with third parties without consent from its subject(s).
- Security: Once collected, personal data should be kept safe and secure from potential abuse, theft, or loss.
- Disclosure: Subjects whose personal data are being collected should be informed as to the party or parties collecting such data.
- Access: Subjects should be granted access to their personal data and allowed to correct any inaccuracies.
- Accountability: Subjects should be able to hold personal data collectors accountable for adhering to all seven of these principles.

Member countries were free to interpret these principles as they saw fit, resulting in a confusing mixture of national rules that sometimes conflicted with each other. The GDPR harmonizes implementation of the principles and extends them in some important ways:

- Consumers must be notified of what data are being collected as a byproduct of a transaction (both in advance of the transaction—while browsing, for example—and as the transaction is executed), and must be able to opt out of anything not explicitly required to complete the transaction. Even necessary data must be able to be "forgotten" once the transaction is completed.
- All use of collected data for *any* purpose beyond the original transaction requires the consumer to explicitly opt in for *each* such proposed use. Blanket opt in will not be allowed, and consumers can change their minds at any time and opt out of a use they previously approved.
- Companies can be audited by the EU and failure to follow the rules ex-

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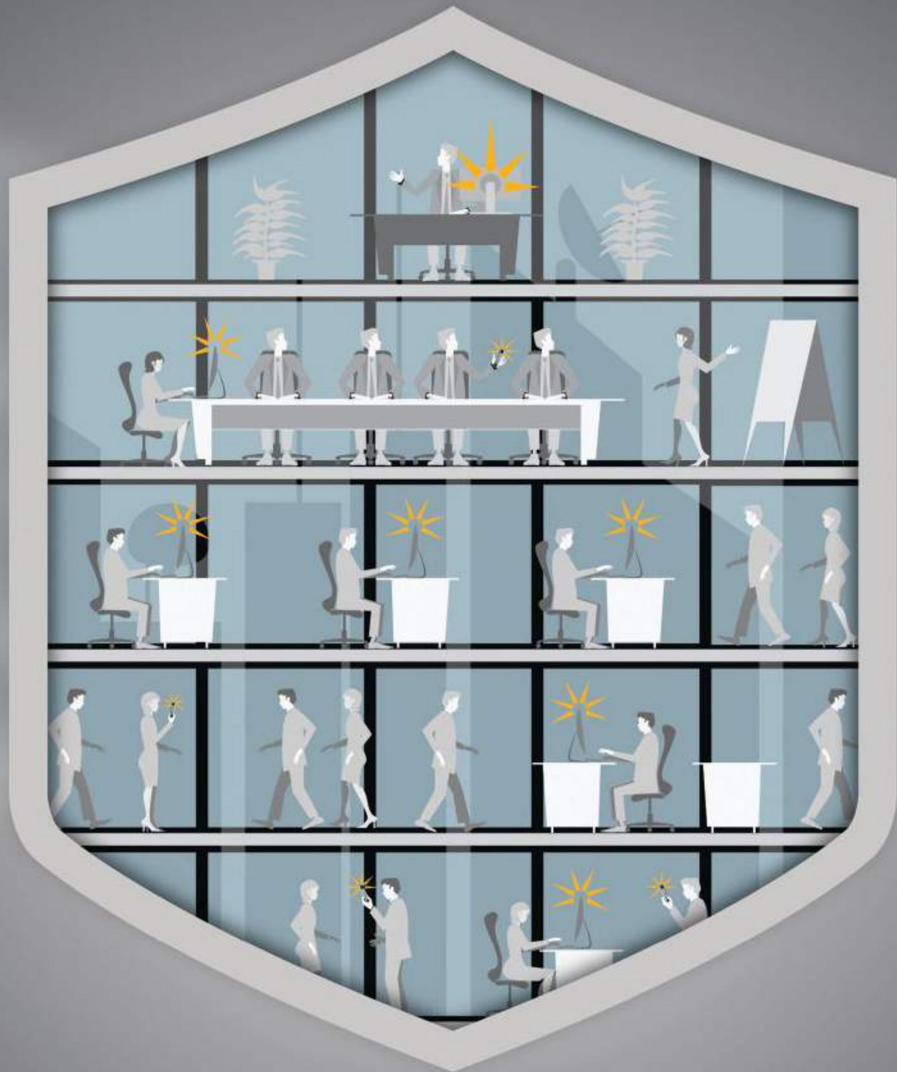

poses them to significant penalties, up to 4% of annual revenue for each breach of the rules.

• Intermediaries (data collectors and data analyzers who sell analytic services to others) will be equally liable. This will essentially force them to police use of their products and services.

These rules are going to fundamentally change things for many businesses. It's an improvement to have a single set of rules across all 27 member states and 320 million consumers (saving EU businesses several billion euros a year in compliance costs). But many information-based businesses will have to figure out how to make the principles real in their online and actually all (paper records count too) interactions with their customers. They will have to do so without annoying those same customers with additional burdens of effort or time. Every loyalty program, cumulative discount, or cashback program and consumer activity database will be affected.

Data collectors will have to design mechanisms to allow consumers to access, verify, and correct their own data. I lived this challenge as chief technology officer at TransUnion, and it's a major headache. Even if every consumer were an honest citizen with no malice of thought or intent, data get corrupted in many ways that may be hard to correct; there is seldom a single source of truth to consult. In the real world, even otherwise honest consumers encounter data they don't like and would rather have erased or changed to look "better." Data collectors will also have to have a nominated Data Protection Officer who will oversee their data privacy processes and protections. No easy answers here, and maybe no practical answers are possible.

The regulation also applies to information related to EU citizens whether or not they (or their transaction) are located in the EU. It would also apply to non-EU citizens transacting while in the EU. How the actual jurisdiction gets applied and managed isn't clear, but it's certainly going to get complicated—potentially requiring the collection of more data that would have to be regulated and then erased.

The regulation might be modified before it's approved as business lobbies push back. Or it may go forward as proposed and become a template for use everywhere, including in the United States. Time to start thinking about potential impacts and strategies to address it. CFO

John Parkinson is an affiliate partner at Waterstone Management Group in Chicago. He has been a global business and technology executive and a strategist for more than 35 years.

Lower Valuations, But More Deals

Forty percent of tech CFOs surveyed by BDO plan to pursue M&A transactions in 2016.

Most technology CFOs expect tech business valuations to cool off this year but nearly all of them anticipate M&A activity will match or surpass 2015's record pace.

BDO USA's annual poll of 100 tech CFOs found that 48% expect valuations to increase in 2016, down from 62% last year when an unprecedented 147 privately held companies exceeded the $1 billion threshold.

Also pointing to a more measured year ahead, less than half (46%) of tech CFOs expect to see an uptick in IPO activity this year, down from 52% of respondents last year. U.S. market volatility was cited as the greatest influence on IPO activity by 26% of the sample, closely followed by global political and economic issues (25%).

But on the more positive side, 74% anticipate higher total revenue in 2016, projecting, on average, an increase of 8.8% over last year. In addition, appetite for M&A remains strong on the heels of a record year for tech deal-making that saw $713.1 billion in transactions.

Forty percent of surveyed CFOs have plans to pursue deals in 2016, while 96% anticipate M&A activity in the sector will stay the same or increase this year and 72% predict acquisitions will be primarily offensive.

"Investor sentiment toward the technology industry has soured in recent months as a number of IPOs have failed to perform and technology stocks took a hit," Aftab Jamil, leader of the technology and life sciences practice at BDO, said in a news release. "However, the chilly IPO environment and share price declines don't necessarily tell the full story. Finance chiefs are bullish about their company revenues as well as their M&A prospects." Or at least they were in the December 2015 to January 2016 period, when the survey was conducted.

"Disruption in consumer tech along with data analytics, cyber, cloud computing, and the burgeoning Internet of Things market will create opportunities for further growth in 2016," said Jamil.

In line with last year's outlook, the BDO survey found that 59% of tech CFOs believe software, including cloud computing, will generate the most deal activity in 2016. The number of software deals increased by 9% in 2015 and total value rose by 72% to $213.2 billion. **MATTHEW HELLER**

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Flex and Flexibility

CFOs at large companies around the world agree: Keep your options open. By David W. Owens

Ask a business prognosticator what's in store for 2016, and likely you'll hear how gloomy the outlook is—particularly overseas. But ask a finance chief, and you may get a response along the lines of that provided by Vsevolod Rozanov, CFO of Sistema, a diversified collection of large Russian businesses. "It is not a time of crisis," Rozanov says, "but a different reality. It presents threats but it also presents significant opportunities."

Similarly level-headed comments were recently made to *CFO* by other finance leaders at several globe-spanning enterprises. Far from pushing the panic button, these finance chiefs are thinking about the best ways to gird their companies to continue to build on gains made in recent years. "We're appropriately frugal," says David Carter, CFO of Suncorp Bank in Australia, "but we're not backing away from investment. We've got to keep investing if we want to have a bank that's sustainable into the future."

Richard Peretz, CFO of UPS, notes, "You have growth, but it's slower and it's sending mixed signals, both within a country or a region, as well as across the globe." These conditions require using a different yardstick to measure success, says Peretz. "A few years back, if you were to expect growth to be 2% to 3%, everybody would look at you and say, 'Well, that's not very good,'" he explains. "But that's the new reality post-recession, so we have to be thinking about how you can take advantage of that."

In the end, says Pascal Bouchiat, senior executive vice president and CFO of Thales, a Paris-based manufacturer, "short-term volatility driven

by economic factors is not preventing us from developing a rather positive view of the overall demand in our key businesses, particularly in emerging countries." In the eyes of Bouchiat and others, it falls to finance to help the business keep its focus on the future.

Bending, Not Breaking

One key for making it through the next year in such a mixed environment, according to the finance leaders interviewed, is figuring out where to pull back and where to flex corporate muscles. Given the wide-ranging scope of many of their enterprises, these CFOs felt it was important to stay flexible and direct resources to the businesses that offered the most solid prospects.

Andreas Schneiter, CFO of Dufry, a Switzerland-based global travel retailer, extols the advantages of geographical flexibility. "Geographic diversification helps us to mitigate or manage the risks that can come from any single location or from any single market where performance may be a bit weaker for whatever reason," says Schneiter. This ability to refocus resources underlies the company's core management philosophy: "We are looking always at the business on a long-term basis. We are not there just for the short term."

For the CFO of Telefónica Brasil, Alberto Manuel Horcajo Aguirre, "The greatest single challenge is maintaining growth in revenue." For that reason, he says, the company also will be looking to "invest surgically," as he puts it, in the territories and the customer bases that can deliver the most value.

The "surgical" view of a company's portfolio becomes even more important as conditions place more constraints on precious resources, notes Sistema's Rozanov. "This year, investment resources do exist, but especially in hard currency, they are becoming scarcer or more limited," he says.

Given that circumstance, Rozanov continues, "we are now starting to compare investment projects across our many industries. We are definitely getting tougher in regard to approvals of incremental opex, and as a rule, the rate of increase in operational expenditures cannot exceed the rate of revenue growth." The business is making a similarly selective review of capex opportunities "case by case," according to the CFO.

Rozanov views this as a necessary response to the shifts taking place in the global economy. As with Dufry, Sistema relies on its ability to mix and

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match strategies across its different markets. Rozanov explains: “[Growth in] some of our industries is focusing on replacing imports with domestic products. But other industries have very good potential to increase their footprint globally because of the favorable dynamics in pricing and in cost.”

So, he concludes, “while we expect declines in investment from some of the group's biggest spenders, we expect to make up for it by growth in the export-oriented businesses and in industries, such as pulp and paper, agriculture, and in a few domestic areas, such as oil services or pharmaceuticals.”

Other companies also will be shifting more resources into newer or growing business segments. UPS’s Peretz provides an example of what he calls “threading the needle.” The strengthening U.S. dollar has clearly put a damper on exports, but, Peretz says, “you’ve got to look for the bright star in that. For us, we see imports into the U.S. growing, both out of Europe and to a lesser extent out of Asia.” Also, for the past two years UPS has been spending more time working with small and medium customers who are exporting for the first time, says Peretz. “That’s an important shift to compensate for the U.S. market, because the middle market is not impacted as much when they’re going into international trade for the first time.”

Innovate or Fall Behind

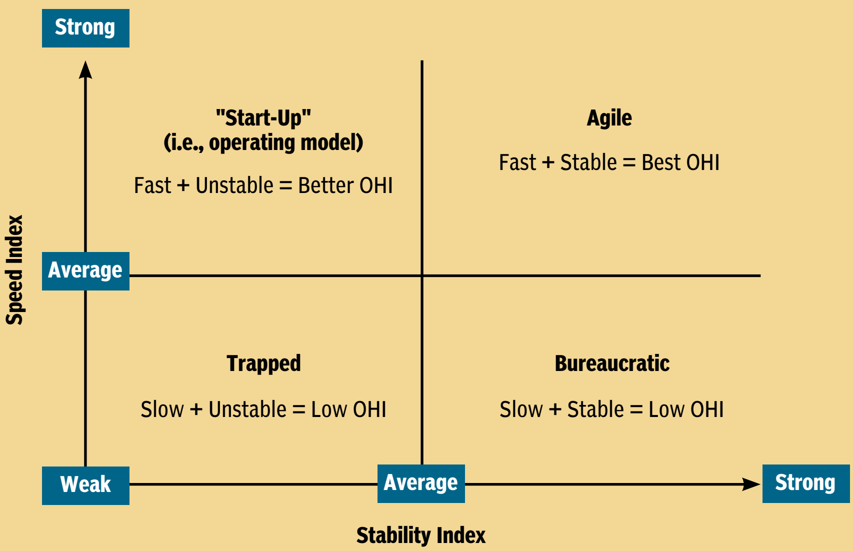
For these finance leaders, innovation goes hand in hand with flexibility. This perspective reflects a subtle shift observed in finance functions from a narrow focus on cost control and toward a more expansive view of the business.

From his vantage point as group CFO, group CIO, and president of group finance and M&A at the diversified Indian enterprise Mahindra & Mahindra, VS Parthasarathy oversees a wide range of businesses and functions. He cites “two paradigms which are in our DNA”: cost leadership and innovation leadership. “In the long run we must be able to do innovation arbitrage, not just cost arbitrage,” he says.

An Agility Index

The strategy consulting firm McKinsey has devised an Organizational Health Index that it uses to compare organizations’ abilities to outperform their competition over time. In the *McKinsey Quarterly* for the fourth quarter of 2015, McKinsey used scores from its OHI database to sort companies by their agility—that is, a combination of speed and stability. In McKinsey’s system, speed is a measure of the ability to make important decisions quickly and adjust rapidly to new ways of doing things. Stability is a measure of a range of characteristics, including clear operating goals and metrics, clear standards and objectives for work, accountability, designing jobs with clear objectives, and devising processes to document knowledge and ideas.

According to McKinsey, the resulting Agility Index shows that the healthiest organizations also are the most agile.



Best Practices for the Agile Organization

The most agile companies were differentiated by 10 best practices that linked closely to better outcomes in key characteristics on the Organizational Health Index: accountability, capabilities, motivation, culture and climate, innovation and learning, and coordination and control.

1. **Role clarity**
2. **Top-down innovation**
3. **Capturing external ideas**
4. **Process-based capabilities**
5. **Operationally disciplined**
6. **Internally competitive**
7. **Meaningful values**
8. **Knowledge sharing**
9. **Inspirational leaders**
10. **People-performance review**

"That means asking, how do we innovate? How do we help innovation in the organization?"

Similar viewpoints are not limited to any one country or company. Thales' Bouchiat emphasizes that "restoring top-line growth is a key target" for the company in the coming year. To help do that, he notes, "we'll keep increasing our R&D expenses, as we did over the last two years. R&D is a very important enabler for Thales, to continue to develop innovative solutions."

In fact, success in the cost area can be a necessary underpinning to success in innovation, according to Jitesh Sodha, CFO of U.K.-based De La Rue, the world's largest printer of commercial banknotes. Sodha says, "De La Rue has a fabulous heritage of innovation, and now it's about taking that further forward. We will be doubling our R&D spend over the next five years, with the focus on driving more innovation."

Here is where the attention to cost control comes into play. "In the optimize-and-flex area, we're looking to continuously drive down cost and reduce our unit cost of production," Sodha says. "We will then take some of those savings and put them into the invest-and-build area."

Thought Leaders And Influencers

In the view of Mahindra's & Mahindra's Parthasarathy, finance professionals will need to evolve to become innovation leaders, central to a company's success in hard times. "I think we [in finance] need to move beyond the paradigm called 'business partnership' and become value creators. A value creator has both functional expertise, on the one hand, and business acumen and business understanding, on the other."

"We don't want accountants anymore," he continues, "because computers can do most of the job. The functional expertise should come from thought leaders and influencers of today and tomorrow."

To become thought leaders and influencers, finance professionals will need to expand their experience base. "For our finance staff, I think the most important thing is to have a broad range of experiences," says Dan Knutson, executive vice president and CFO at food and agricultural cooperative Land O' Lakes. "I would want somebody to have worked in each one of our businesses at one point, to be alongside that business partner, to be a valuable source of information, to be able to analyze data quickly and provide insights as well as to challenge."

Flexibility in working relationships can be as important as flexibility in business devices.

For Angie Lim, CFO for the Asia Pacific region of the financial and professional services firm Jones Lang LaSalle, developing finance staffers with wider skills is one of the more important challenges she faces. "What you're looking for," she says, "are 'people people' who are analytical, but also have good communication skills, and can interact and communicate and engage with others."

The ability to engage with business partners and analyze information is "something that you don't find in every accountant," Lim says. "A lot of them take the numbers and then run with it, without understanding what is happening behind the scenes. I think that's a danger with the newer accountants that I'm seeing."

Dufry's Schneiter also notes, "If you want to be successful, you need to have a good view on what really are the requirements in the organization, and not only what the requirements are for the team." For Schneiter, that means being a good listener, among other things. He doesn't see many hard and fast lines between finance and the rest of the enterprise, commenting, "Nowadays within the finance function, it's so integrated with the operational part of the business, you really need to be in a position to understand what other people need from you."

As UPS's Peretz sees it, "It is about understanding outside perspectives. It's a culture that's about helping the person grow as a leader. When I became CFO, the big change for me was opening my eyes to how much time I spend on the business side. So I would ask future leaders to have additional assignments in the direct operation of the company."

In this kind of world, flexibility in working relationships can be as important as flexibility in business choices. At Suncorp Bank, for example, "we think a little bit differently about how to access talent," says CFO Carter. "The basic accounting work can be done anywhere. It can be done by machines, virtually. So we have a very flexible working environment here—people with very different backgrounds who may not always be around you in the office. They might be working outside the office, they might be working part-time, they might be very different age ranges or from different generations altogether." It takes a special sort of finance professional to be up to the task of keeping in step with the changes in the workplace, as well as in the marketplace.

Parthasarathy concludes by emphasizing the need for keeping one's eyes open to all the possibilities. "It goes far beyond simply saying this reduces cost, or that increases revenue," he says. "Your insight and analytics may save cost in one instance, and they may identify new business opportunities coming up in another, or they may signal a danger coming ahead." All of these help create value, he notes, and the finance professional prepared to pitch in at any moment, on any decision, will be the one who becomes the true value creator. CFO

Finance Is Adapting a Millennial Approach to Technology In Order to Lead the Enterprise

The CFO of a software firm stated the obvious: The millennial generation lives and dies with technology—it is embedded in them.

Millennials coming into finance expect things to happen much more quickly, according to a steel producer's manager for corporate treasury. This makes them particularly well suited to adapting to a more complex, faster-moving, and far less structured digital world.

These two finance executives were among those interviewed as part of a recent CFO Research study, which included a survey of 1,544 finance professionals around the globe. Sponsored by SAP, the study sought to gain a better understanding of the outlook for the finance function and what finance professionals see as the key enablers of their future success.

A Necessity, Not a Preference

The software CFO hastened to add that technology is not just a matter of preference for millennials. He explained that the next generation will require a comfort and dexterity with a higher order of technology in order to successfully manage the business challenges of a more complex world. Because of this reality, he noted, technology for finance must improve business processes and become more proactive and automated every day.

Globalization has given finance teams access to many different resources that they didn't have in the past—different tools, different benchmarks, and different companies. This wealth of information creates the expectation that finance will now be able to build on that and be more innovative—to create more added value on top of what's already been done.

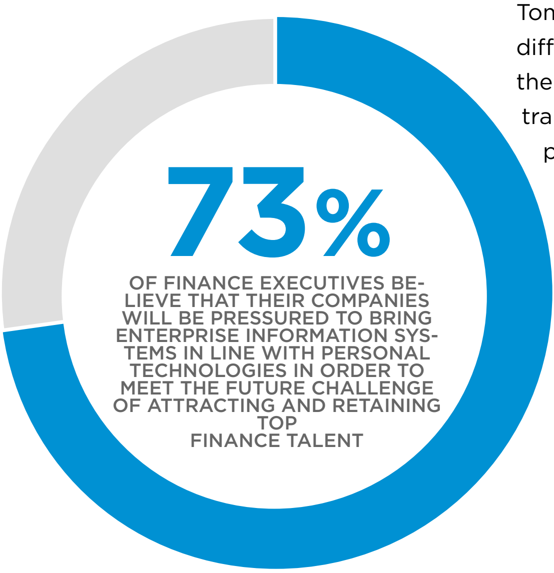
But information and innovation does a company little good unless it can be used to influence decisions and guide the business forward. This is one of the more powerful byproducts of the ease with which a new generation adapts to a vastly expanded universe of information.

The economist for a mining firm shared a related vision for the future of finance that uses many tools in a faster way to have more information. He concludes that finance people who can open their minds will be able to lead the company "to another way."

Meeting A Consumer Standard

The survey found that finance professionals believe their companies must bring enterprise IT up to the standards that consumer IT—smartphones, tablets, etc.—has established for speed, flexibility, and ease of use. Seventy-three percent of survey respondents believe that their companies will be pressured to bring enterprise information systems in line with personal technologies in order to meet the future challenge of attracting and retaining top finance talent.

The CFO of a financial services company called the new generation in finance "digital natives," noting that for them it's completely normal to have much better IT equipment than people had ten years ago.



In fact, the next generation of finance professionals and business managers won't understand why systems have different versions of the truth (e.g., planning and accounting), and they won't be willing to work around those different versions. The next generation will want to be able to access anything on their phone, and they'll want answers in real time. The large enterprise systems in use today will need to accommodate those expectations.

The latest generation of finance technology actually delivers against these requirements, enabling the finance function to more predictive and more agile in reacting quickly to any scenario. In fact, it's an exciting time to be a finance professional. Eighty-two percent of survey respondents say their jobs have exceeded their original expectations for interesting, meaningful, and valuable work. In fact, 27% say that their expectations have been substantially exceeded.

Finance Team of Tomorrow

Tomorrow's finance teams will look different from today's, and now is the time to start thinking about that transition. Those entering the finance profession today can look forward to a career that is more deeply engaged with, and contributes more value to, the business they support. Those who are already well into their careers are finding new challenges in

making the transition, but most are excited to face those challenges and turn them into new opportunities for their own growth.

Underlying the evolving mandate for finance, as well as the higher expectations that other management has for their finance colleagues, are changes taking place in the global business environment. Information of all types, structured and unstructured, is being generated from more sources than could be imagined only a short while ago, and a company's success will depend increasingly on its ability of to capture that data, analyze it, and make immediate decisions under rapidly changing conditions.

The view of the future of finance is so encouraging that finance leaders are now also influenced by the millennial work style and approach to technology, which both represent a major change from the business worlds they were brought up in. In a finance world where innovation has not always been embraced, the strength of the new vision is overcoming the fear of change.

ACTIVIST INVESTORS ARE BIGGER AND HUNGRIER THAN EVER. HERE'S HOW TO KEEP THEM AT BAY.

Activists At The Gate

BY EDWARD TEACH

Your company could be doing better. The stock is in the doldrums, and the price-to-book ratio is low. On a variety of financial measures—shareholder returns, revenue growth, operational costs, and so on—the company is underperforming its peers. Cash flow is reasonably healthy, but one of the divisions is starting to falter. Adding insult to injury, management won the last say-on-pay vote by less than a large margin.

Your company, in short, is a prime target for an activist hedge fund. Such investors make money by taking stakes, and board seats, in public companies and pressuring them to put themselves up for sale, spin off the parts, repurchase stock or increase dividends, or make operational changes. Activist funds have outperformed other types of hedge funds in recent years, attracting capital inflows. They currently boast more

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than $150 billion in assets under management, says Paula Loop, leader of PwC's Governance Insights Center, "and they are looking for places to invest in."

Last year, activists found a record number of places to invest in. FactSet's sharkrepellent.net tallied 355 campaigns, with 127 resulting in at least one board seat gained for the activist. Ernst & Young counted 516 activist encounters last year, up 24% from 416 in 2014. And the targets are getting bigger, with megacap companies like DuPont, Procter & Gamble, Apple, and AIG coming into activists' crosshairs.

Descendants of (or in some cases, holdovers from) the corporate raiders of the 1980s, today's most prominent activists—investors like Carl Icahn, Nelson Peltz, Bill Ackman, and Daniel Loeb—are rock stars on Wall Street. More collaborative in tone than confrontational, current activists are winning fans among traditional institutional investors.

"The shareholder base is shifting," says Bill Anderson, senior managing director and head of the shareholder advisory practice at Evercore, an investment banking advisory firm. "The big mutual funds that are active holders used to be more supportive of management, but now they are supporting the activists—and that's a giant change."

The *Wall Street Journal* reported that more than half of activist campaigns in 2015 were launched by "reluctavists," normally passive investors who were goaded into activism by poor corporate performance. "We may continue to see 'reluctavists' play a significant role in campaigns," says Richard Grossman, a partner in the M&A practice at Skadden, Arps, Slate, Meagher & Flom who frequently advises firms in response to activist situations.

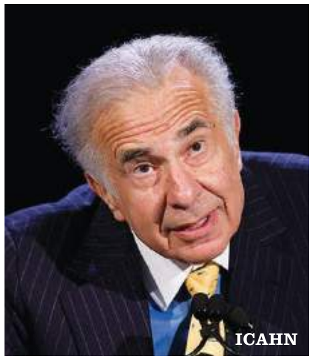
"It's not just activists, but shareholders as a whole who want a voice—that they are investors, they are owners of a company, and they are not quite as content just to sit back and let management handle things," says David A. Brown, a partner at law firm Alston & Bird who advises companies on shareholder activism. "Even large institutional investors who are not activists, such as BlackRock, are publishing voting policies and their views on how things should be run."

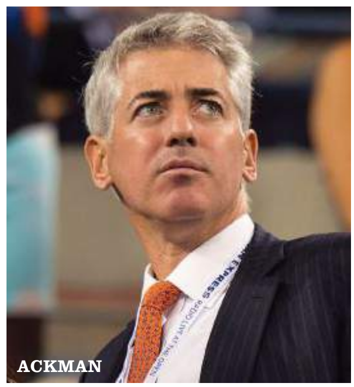
As activism goes mainstream, company size is no protection. A fund that holds a few percent of a target's stock potentially has an unlimited amount of financial clout, "because if I can convince the big, traditional institutional investors to support me, I have all the investment money in the world at my disposal," says Shyam Gidumal, a principal at Ernst & Young who advises clients on shareholder activism.

A Growing Dialogue

In the past, companies could simply circle the wagons and wait for activists to go away. Now they are parleying with them, and often they are settling their differences quickly. In 2015, for example, Icahn Associates, Starboard Value, and Pershing Square Capital Management struck settlements with targets and placed members on their boards soon after they surfaced. At General Motors, activist Harry Wilson dropped his intention to seek a seat on the board when GM, after meeting with Wilson, announced a new capital allocation framework and share repurchase program. (GM says the initiatives had already been in the planning stage.)

The growing dialogue between companies and activists was acknowledged by Securities and Exchange Commission chair Mary Jo White in a 2015 speech at Tulane University. "Increasingly, companies are talking to their shareholders, including so-called activist ones," White said. "That, in my view, is generally a very good thing. Increased engagement is important and a growing necessity for many companies today."





FEARSOME FOURSOME
Clockwise from top: Activist investors Carl Icahn, Nelson Peltz, Bill Ackman, and Daniel Loeb

"I think a lot of companies were hoping that the SEC was going to defend companies from the activists," comments Gidumal. "To me, that was another indication of a secular change in the way investors talk with companies." He views activism not as an asset class, but simply as "a core part of the conversation that investors have with companies."

That doesn't mean they're singing "Kumbaya." Activists may be openly adversarial, while CFOs may scoff at proposals to drain the corporate cash coffers or slash research and development spending. Moreover, "there are any number of activists whose ideas don't make sense," points out Gidumal. An activist may be well intentioned but lack crucial informa-

> **"Increasingly, companies are talking to their shareholders, including so-called activist ones. That, in my view, is generally a very good thing."**
>
> **MARY JO WHITE,** Securities and Exchange Commission chair

tion, such as the company's tax basis. "It can be that the company says we've heard that idea before, it's a bad idea, and here's why," says Gidumal.

Sometimes companies wait too long to disclose facts to refute an activist's argument, says Gidumal. He recalls one retailer that sparred with an activist for nearly a year over whether to spin off its real estate holdings, until it finally convinced investors of its case by revealing that the tax costs of the separation would outweigh the deal's benefits.

"Bringing the facts to the table and being crisp in your messaging" enables a company to resolve an activist encounter quickly, and puts the activist in a better position to exit, says Gidumal. He says that for every activist encounter that becomes public, another one is resolved privately, with no change to the board.

Becoming Your Own Activist

To respond to activists effectively, consultants like Gidumal urge companies to, in effect, become their own activists. "Look at yourself the same way an activist would look at you," he says. "Understand and articulate what you think activists might argue, and why you believe that you as a company are doing the right thing."

Brown says companies don't necessarily need to think like activist investors, "but they do need to focus on their long-term strategy for creating shareholder value, as well as opportunities in the short term to return cash to shareholders through dividends or share repurchases."

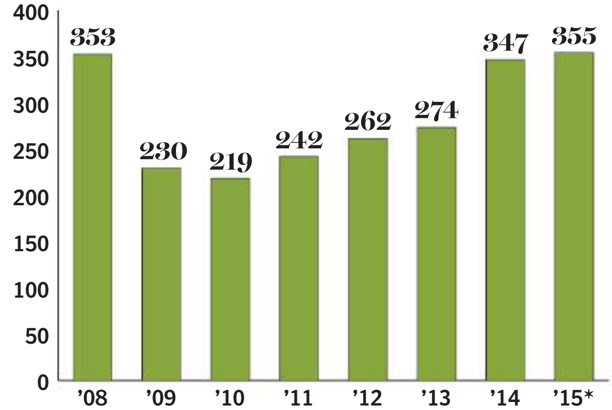
He recommends that companies form an activist response team, ready to evaluate a hedge fund's approach and history. "Some activists are focused on long-term value creation and have a good track record of being long-term shareholders and helping companies, which benefits the activist through long-term share price appreciation," he says. Other activists "may want to simply force a company to expend cash or lever up for special dividends or share repurchases, which drains the company of resources."

Skadden's Grossman notes that many companies now perform vulnerability self-assessments. "Generally, it's a good thing," he says. The self-assessments "are designed ultimately to enhance shareholder value, which is what

A VERY ACTIVE YEAR

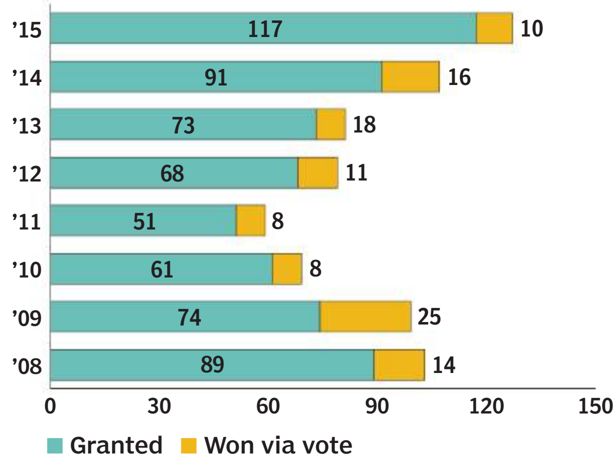
SHAREHOLDER ACTIVISM IN 2015

U.S. Activism Campaign Announcements



*2015 as of December 14, all others full year

Campaigns Resulting in Board Seat(s)



Based on seat won/granted date

Activist campaigns against U.S. companies (focused on value creation, public short, board seats, and officer/director removal) reached a record high in 2015. Also, activist campaigns that resulted in at least one board seat for the activist (or the activist having a meaningful say in the appointment of a new independent director) reached a new high.

Source: FactSet sharkrepellent.net

Getty Images

boards and management teams should be doing." CFOs, he says, play "a major role, if not the lead role" in vulnerability self-assessments, since such scrutiny typically focuses on financial performance.

Meanwhile, companies need to win the hearts and minds of their shareholders—before activists do. "Companies need to talk to their large shareholders year-round, to understand their concerns," says Brown. "So if an activist does knock on the door, you're already involved with your shareholder base." Brown says companies should also get acquainted with the two main proxy advisory firms, Institutional Shareholder Services and Glass Lewis, whose voting recommendations carry considerable weight with large institutional investors.

Direct discussions between board members and a company's largest shareholders can serve as an early warning system of investor unhappiness, and enable directors to communicate management's strategic vision, says Grossman. Such engagement "is still evolving so that it does not encroach on the traditional role of management communicating with investors," he adds.

"Years ago, it was unusual for directors to meet with shareholders," notes Evercore's Anderson, but today it's common practice among companies in the *Fortune* 200 to have at least one director designated to do so, he says. The board's message to shareholders should be more narrative than data dump, recommends Anderson. Instead of assembling "100-page slide decks," directors should keep it simple, he says, focusing on the five or so yardsticks that are most important to the business and its investors—its margins, cash flow, leverage, and so on—and how the company stacks up against its peers on each.

GOVERNANCE ACTIVISM

As the coming proxy season will demonstrate, activist hedge funds aren't the only shareholders taking a greater interest in corporate affairs. "Corporate governance activists are starting to be much more vocal," says David A. Brown, a partner at law firm Alston & Bird's Washington, D.C., office.

Earlier this year, for example, New York City Comptroller Scott Stringer filed proxy access proposals at 72 companies on behalf of the New York City Retirement Systems, as part of the pension system's Boardroom Accountability Project. The proposals call on companies to allow investors owning 3% of their stock for three or more years to nominate directors on the companies' own proxy ballots, instead of having to spend money on their own campaigns. Proxy access was the most-submitted governance proposal in the 2015 proxy season, according to sharkrepellent.net, and will likely be the top such proposal in 2016.

Meanwhile, having introduced significant voting policy updates in 2014 and 2015, proxy advisory firm Institutional Shareholder Services continues to focus on equity compensation and pay-for-performance, and will recommend "no" votes on say-on-pay if it determines that a CEO's compensation is out of line with measures of company performance, such as total shareholder return.

And starting in 2017, ISS and proxy adviser Glass Lewis will give a negative recommendation for non-CEO directors who sit on more than five public-company boards. Such directors are currently considered to be "overboarded" if they sit on six such boards. As the rise of activism makes the board's job more difficult, Brown says the new overboarding policy could make skilled, experienced directors harder to find.

New York City Comptroller Scott Stringer filed 72 proxy access proposals on behalf of the New York City Retirement Systems, as part of the pension system's Boardroom Accountability Project.

Courtesy New York City Comptroller

Finally, a hardy governance perennial, shareholder proposals calling for an independent chairman, has been trending up over the past four years. But the proposals rarely succeed: of the 63 that came to a vote in 2015, only 2 passed.

Of course, activist hedge funds target underperforming companies to make money, not to improve governance practices per se. "A company who's doing great, whose stock is rising, who has a higher multiple than its peers, but who may have potential governance issues is unlikely to be subject to an activist attack," says Richard Grossman, a partner at Skadden, Arps, Slate, Meagher & Flom. A fund may use governance issues as a wedge, he notes, "but governance on its own doesn't typically attract activists, except in extreme cases." E.T.

Operational change is a far more invasive strategy. "Companies are only beginning to recognize how fundamental a shift this kind of activism is."

—SHYAM GIDUMAL, principal, Ernst & Young

Grossman downplays concerns that directors risk violating Regulation FD by talking directly to shareholders. "Directors are out meeting with shareholders all the time in contested situations," he says. "They know what the constraints of FD are when it comes to disclosing material nonpublic information."

Of course, a company's board is itself a potential weak point. Increasingly, activists are using top search firms to find candidates who are former executives in the industry, says Anderson. Such new blood "can be attractive to institutional investors," he says. "Boards have to take a tough look at themselves and ask whether their shareholder base would believe that they are the right board for that company."

"The board has to look at itself in the mirror and make sure they understand what their vulnerabilities are," says PwC's Loop. "Sometimes the management team can push back on the board. For example, you could have directors who effectively have 'zombie' status—they didn't receive majority voting in the prior proxy season. Sometimes someone has to say, maybe we need to make some changes here as well."

Some companies have effectively preempted demands for shareholder representation on their boards because they have former fund officials on their boards, Anderson points out. Apple, for example, has a founding partner of BlackRock on its board, and General Electric has a former Vanguard CEO on its board.

"Companies need to talk to their large shareholders year-round, to understand their concerns. So if an activist does knock on the door, you're already involved with your shareholder base." –DAVID A. BROWN, PARTNER, ALSTON & BIRD

A More Invasive Strategy

While most activist campaigns continue to address board seats, balance sheets, and break-ups, a fast-growing theme is core operational change—reducing costs, becoming more efficient, increasing returns on invested capital. In 2010, 7% of activist encounters involved operational change, according to EY; last year 25% did.

While putting a company up for sale and liquefying the balance sheet are discrete processes, operational change is a longer-term, more invasive proposition, says Gidumal. It can take years, for example, for a large, multidivisional company to reduce its supply chain costs by 500 basis points, he points out.

"That's a big change in the nature of an activist engagement with a company," notes Gidumal. "It changes what kind of board members an activist might propose. It changes how the board will talk to management, how the management will talk to the board. Companies are only beginning to recognize how fundamental a shift this kind of activism is."

Are activist hedge funds another investment fad, or will they remain popular? "I don't see the activist funds going away," says Grossman. "But the low-hanging fruit may be gone, and they may have to work harder to find targets."

Like other asset classes, activist funds had a tough 2015; Hedge Fund Research's index of activist funds finished the year up just 1.5%. While HFR's activist index has outpaced other hedge fund indices, it has trailed the S&P 500 in five of the last eight years.

In recent years, many activists have been prodding companies to split up. "That may have made a lot of sense when the market was strengthening and people were focused inwardly post-crisis," says Anderson. "It pushed some spinoffs to happen sooner than they otherwise would have." But lately, such separations haven't performed as well, he says; "a number of SpinCos have traded below expectations."

Once activists cash out, how will their targets perform? "The jury is still out," says Grossman. Despite claims that activist investors are "pumping and dumping," a recent study of activist interventions between 1994 and 2007 by Harvard Law School professor Lucian Bebchuk and others found that Tobin's Q and return on assets were consistently higher three, four, and five years following the interventions. Similarly, a McKinsey study of 400 activist campaigns against large U.S. companies found that the median campaign reversed a downward trajectory in target performance, and created a sustained increase in shareholder returns.

Such evidence suggests that activist investors frequently advocate sound ways to boost corporate performance and create shareholder value. Which points to the best defense of all against activists: Beat them to the punch. CFO

EDWARD TEACH IS EDITOR-IN-CHIEF OF *CFO*.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SPECIAL SECTION: ENTERPRISE IT

THE DIGITAL CFO

From ERP systems to smartphone apps, information technology is reshaping the role of the chief financial officer.

BY CHRIS SCHMIDT

The evolution of information technology has shaped the working lives of senior financial executives, changing what it means to be a CFO. When it is managed well, technology connects finance with every function and informs every strategic decision—the nervous system and analytical core of the modern enterprise. When it is managed poorly, technology saps competitive strength from even the strongest company, affecting earnings and valuation.

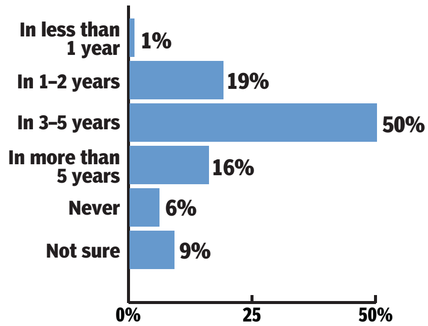
To gain a better understanding of how CFOs manage and use both corporate and personal technology, CFO Research recently surveyed 267 U.S. senior finance executives. One thing quickly became clear: IT has become deeply enmeshed in the finance function. “Finance is IT,” said one survey respondent. “They are no longer separate items. Without IT, you can’t do finance.”

An astounding 93% of the senior finance executives surveyed believe that the CFO of the future will need a much stronger technology skill set than is currently required for the job. An impressive 64% of survey respondents have taken specific actions to upgrade their technology skills during the last year, and 80% of respondents plan to do so during the coming year.

The reasons that an enhanced skill set is required were also amplified by the survey. Four out of five respondents believe that their organization’s IT strategy is an essential component of its growth strategy, and even more respondents (86%) believe it will be an essential component in two years’ time.

Figure 1

If you believe there is a usability gap between consumer technology and finance technology, when do you expect the gap to be closed?



Percentages may not add to 100%, due to rounding.

Managing Enterprise IT

Currently, 74% of respondents say that they would be very comfortable providing management oversight of their organization’s IT strategy (for example, with the CIO reporting to them), and 82% expect that they would be very comfortable in this role in two years’ time. Looking only at survey responses from CFOs, 88% indicate they are comfortable providing management oversight of IT now, and 92% indicate they would be very comfortable in this role in two years’ time.

Survey participants were asked what advice they would give to their peers who are newly assuming management oversight of their organization’s IT strategy. Their responses covered several aspects of the finance executive’s role:

• **Technical competency.** A director of finance recommended that finance chiefs “learn and understand the technical jargon so they can have a deeper understanding and discussions with the CIO.” A CFO added: “Don't be afraid to admit you don't know what you don't know.” Another finance chief suggested requiring “a roadmap to understand IT's vision for both infrastructure and applications.” Still another CFO suggested a forward-looking approach to developing personal technical competency: “Build your knowledge on future developments—the cloud, the Internet of Things—and on [intelligence about] where your industry is heading.”

• **Enterprise IT strategy.** An executive vice president of finance counseled: “Stay focused on overall corporate goals and priorities, and have IT spend and prioritization align with them.” A CFO added: “Remember that IT is not a pursuit in and of itself. Keep business goals in mind.” Summarized a manager of IT financial analytics: “Don’t be enamored of shiny objects. Know your user base and use cases before investing in new technology.” To inform strategic decisions, a CFO advised his peers to “make sure you have management dashboards to help find answers to your questions instead of relying on subordinates to give you the filtered information they think you want.”

A head of global business services suggested: “Constantly take a critical look at the services your IT organization is providing and ask if they can be bought as a commodity easily from outside, or if someone can deliver the service better. Balance the insource-to-outsource ratio on a regular basis to avoid building a large fixed-cost base.” A CEO suggested phrasing this query more bluntly: “Why we are doing everything in-house?”

• **Tactical decision making.** A vice president of finance advised CFOs to “really understand how you got to the current IT environment as a basis for making decisions about what may need to be changed going forward.” A CFO noted that finance chiefs’ role in risk management requires them to “thoroughly understand how security and privacy are managed by their IT group and through their IT infrastructure.”

Managing Finance IT

Technology’s prominence in the finance function continues to grow. Seven in 10 (70%) respondents believe that the percentage of their finance budget that is devoted to technology will increase in 2016. Only 2% believe that this percentage will decrease.

And the responsibilities related to managing technology continue to keep pace. Nearly two-thirds (65%) of respondents believe that the amount of time they personally devote to managing finance technology will increase in 2016. Only 3% of respondents believe this amount of time will decrease in 2016.

One-quarter (25%) of respondents currently access their organization’s core financial information systems via smartphone or mobile device, and 78% of respondents believe that there is a large gap in usability (regarding the interface and user experience, for example) between consumer technology and finance technology. Of those who believe that there is a large gap in usability, more than 7 in 10 (72%) expect that it will take at least three years to close the gap. (See Figure 1.)

ERP System Attributes Needing The Most Improvement*

1. Reporting and display
2. Ease of customization
3. Integration with other systems
4. Ease of implementation
5. User-friendliness

*Top five (of nine) attributes receiving the strongest "needs improvement" scores

Respondents whose companies have an enterprise resource planning system indicated that the system they use most often needs the most improvement in "reporting and display," followed by "ease of customization." (See list above.) In addition, an open-ended survey question asked what one thing respondents wished their ERP system did better, and "reporting" was cited far more frequently than any other response.

The fact that respondents saw opportunities for substantial improvement in all the attributes listed points to the challenges of ERP system management. Respondents were also asked what advice they would give to their peers who are newly assuming management oversight of their organization's ERP system. Again, responses covered multiple areas:

• **Strategy.** A CFO counseled: "Align ERP enhancements with your overarching IT vision. For me, that means making it easy for our customers to do business with us and enhancing efficiency and productivity." Another CFO added: "Prioritize the key pieces that will ensure that you are compliant with requirements for your industry. Then focus on maximizing those pieces." She concluded: "Ensure that all existing systems are using full capabilities before adding more systems. Do not let systems be added in silos, to support siloed teams."

• **Configuration.** An IT finance director suggested to "keep it as 'vanilla' as possible. Customization leads to increased cost of ownership as upgrades are needed." A CEO summarized: "Use the cloud and keep it simple."

• **Reporting.** A controller cautioned: "Don't adapt your reporting to the system. Find a system that works with your reporting." A financial reporting manager added: "Get user-driven reporting set up early (that is, so you are not reliant on IT)."

• **User Experience.** A treasurer counseled: "Use champions/power users in each department as go-tos for department users." A controller suggested: "Get training on the system—significant training." A CFO added: "The loudest complainers may not be the parts of the system that need to be addressed first. Do your homework on the return on investment in changes/integrations/customizations."

Personal Relationship with IT

Respondents' personal relationship with technology is shifting as well. Figure 2 shows that senior finance executives have made a concerted effort over the last five years to "stay current" with technology. Interestingly, though, the percentage of self-described technology "geeks" and "early adopters" in the senior finance ranks has declined.

We asked respondents to tell us their favorite apps, both those that are related to their finance roles and those that are part of their personal lives. The apps cited most frequently that are related to a finance career (in addition to those associated with enterprise/business intelligence systems) can be categorized into news/markets (for example, the *Wall Street Journal*), research (Google), financial calculation (HP 12C), productivity (Evernote), expenses (Concur), and networking (LinkedIn). A controller summarized the focused-app strategy of many respondents: "Most of my mobile usage for finance is based on the acquisition of news and information."

The personal apps most frequently cited (in addition to personal banking and investment apps) were related to music (for example, Pandora), fitness (MapMyRun), commuting (Waze), dining (Open Table), wine (Vivino), travel (TripAdvisor), sports (ESPN), and social media (Facebook). Perhaps the most unexpected personal app cited was Fish Rules, which employs GPS locating to keep users apprised of the saltwater fishing laws and regulations relevant to a given location.

But several respondents noted that they intentionally limit personal apps and avoid social media, citing the risk of a social media miscalculation. One senior finance executive drew a clearer line: "I view technology as a vehicle for business and do not use it for personal reasons."

Which is probably just as well. After all, more than one executive has landed in hot water for an inappropriate tweet or Facebook post—you can Google it.

Figure 2
How would you describe your personal relationship with technology?

	5 Years Ago	Today
Enthusiast/Geek	10%	8%
Early Adopter	27%	20%
Staying Current	42%	56%
A Generation Behind	16%	15%
A Few Generations Behind	4%	1%

Does not include <1% of respondents who replied "Not Sure." Percentages may not add to 100%, due to rounding.

CHRIS SCHMIDT IS DIRECTOR, RESEARCH AND CUSTOM CONTENT, AT CFO RESEARCH.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Share and Share Alike

A new law could enable companies and the government to share data about cyber threats without compromising privacy.

By David M. Katz

In a case with arguably national implications, a lengthy legal battle between lawyers representing the Obama administration and Apple came to a head on February 16, when a federal judge ordered Apple "to build a backdoor to the iPhone," in the words of Tim Cook, the company's chief executive. The judge ordered the company to supply FBI investigators with access to encrypted data on the iPhone of one of the shooters in the San Bernardino, California, attacks that killed 14 people in December.

"Specifically, the FBI wants us to make a new version of the iPhone operating system, circumventing several important security features, and install it on an iPhone recovered during the investigation," Cook wrote in an open letter on the day of the ruling. Contending that the ruling sets a "dangerous precedent" that could provide the government with "the equivalent of a master key" unlocking the encrypted business and personal data of mobile phone users, the Apple CEO wrote that his company opposed the order, "which has implications far beyond the legal case at hand."

Many observers believe that the battle over iPhone data marked the opening skirmish in a debate on the tradeoffs between data privacy and national security. But in December 2015, President Obama signed into law an act that its proponents say offers a framework for resolving a debate on a related matter: the ability of companies to share information about cyber threats with each other and with the federal government.

Despite a widely held assumption that businesses can better defend themselves against hackers collectively than they can alone, many companies have been wary of revealing data about potential attacks to their peers or governmental bodies. One reason is the risk of inadvertently divulging trade secrets. And even if they're able to keep their intellectual property secure, companies worry about accidently exposing their customers' personal information. They also fear being hit with antitrust charges for erroneously sharing pricing information with competitors.

Enter the Cybersecurity Information Sharing Act of 2015. A good six or seven years in the making, CISA enables companies to voluntarily share facts and data about impending cyber threats with the federal government and with other companies. If they properly scrub their data of personally identifiable information that's irrelevant to the threat, they'll be immune from certain liabilities and won't be charged with violating antitrust laws.

The act "helps to resolve some of the lingering privacy and regulatory issues that may have inhibited some companies from sharing cybersecurity information," says Ed McNicholas, a law partner at Sidley Austin. "But I think the real benefit that you'll see for cybersecurity is that because more companies will start sharing more information, we will see a stronger defensive network spring up, and that will lead to more cybersecurity."

The rules of how CISA will work still have to be developed under the auspices of the act's primary administrator, the Department of Homeland Security (DHS). Some lawyers say definitions of terms in the law such as "cyber threat indicator" and "cybersecurity" need more specifics.

Further, even though the act is voluntary and contains a number of barriers to excessive government prying, the privacy concerns of Apple and other information technology organizations that held up the law for years don't seem to be going away any time soon. In short, a full picture of the benefits and risks for corporations in the sharing of cybersecurity information is a long way from completion.

Coordinating a Defense

Nevertheless, the case for mounting a widely coordinated corporate defense against cyber attacks has grown more compelling as the coordination of hackers and the scope of hacking has grown. "It's been a problem for cyber-

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security defense in corporate America that the attackers are often more organized," says McNicholas, noting that hackers now share information and techniques and make use of entities that finance their operations and create markets for stolen information. "The attackers are organized," he adds. "The defense has not been as organized."

One of the most important hoped-for advantages of coordinated corporate information sharing is that it will significantly cut response times to cyber attacks, which can often proceed undetected for months. In 2014, for example, the median amount of time that hackers were present on a victim's network was 205 days, according a report based on the cybersecurity investigations of Mandiant Consultants.

"From a CFO's perspective, if I can detect and mitigate that threat within weeks instead of months, I have a real chance to preserve the value of my company."

» **Matt McCabe, SVP in the cyber practice of Marsh**

To be sure, that represented a decrease in days from 229 in 2013 and 243 in 2012. But the worst-case scenario still represents a corporate nightmare. "Breaches can go undetected for years," declared a press release on the report. "In an extreme case, one organization that Mandiant responded [to] in 2014 had been breached for over eight years unknowingly."

Indeed, despite considerable advances in computer threat detection, the notion that hackers can lurk undetected on a company's network for as long as six months suggests the "enormous potential damage" corporations face if they're attacked, according to Matt McCabe, a senior vice president in the cyber practice of Marsh, the big insurance broker.

But another company may pick up signals of an attack in progress earlier than the company that's being hacked. And if it can freely share such threat information with the company under attack, a great deal of damage presumably could be averted. "From a CFO's perspective, if I can detect and mitigate that threat within weeks instead of months—maybe within days instead of weeks or months—I have a real chance to preserve the value of my company," says McCabe.

The ISAC Model

Working on such assumptions, companies have been sharing information on cyber threats long before CISA, although on a much more limited basis than what's envisioned under the act. In particular, the activities of Information Sharing and Analysis Centers (ISACs) have provided a model for companies to share cybersecurity information amicably and without fear of revealing trade secrets, experts say.

In a typical ISAC, a group of the chief information security officers and other information security operatives within a given industry share information on a secure online portal and periodically meet in person, according to McNicholas. "It's a way that the companies can interact with each other and with the government in a secure manner, dealing with people who are known and trusted," he says.

"This also allows the government to vet the people who are involved so that you don't have a rogue element get into the middle of the ISAC, which would be in no one's interest," he adds.

Created under a presidential directive in 1998 and updated in 2003 to reflect the involvement of the recently formed DHS, the ISACs are nonprofit, sector-specific groups of companies that share information about cyber threats and physical threats. Currently, the 24 centers include ones coordinating the efforts of the retail, real estate, electricity, water, and—most notably—financial services industries.

Formed in 1999 and funded by its member companies, the Financial Services ISAC is widely regarded as the most firmly established of the centers. "The FS-ISAC gathers threat, vulnerability, and risk information about cyber and physical security risks faced by the financial services sector around the world," the group's website states. "After analysis by industry experts, alerts are delivered to participants based on their level of service."

What that means is that an employee of a center member can create a notification profile on the FS-ISAC website that identifies specific areas of interest or receives all alerts. The alerts describe the threat or vulnerability, its severity, and recommended solutions.

The sources for the alerts include vendors, academics, community emergency response teams, and government and law enforcement agencies. "However," FS-ISAC says in boldface on its website, "it is a one-way flow of information: NO government agency of any type or law enforcement agency has any access to member-submitted events without prior approval of the submitting financial institution."

CISA, however, does not appear to mention prior or written approval for government access to company information, although the act aims to "incorporate" the existing processes, roles, and responsibilities of ISACs. Nor, apparently, does the law address how a company can indicate that it's volunteering to participate under the act. That will likely have to wait until the DHS rolls out its final CISA policies and procedures, which it is required to do no later than May.

Through their participation in ISACs, many companies have already seen such benefits as the ability to communicate with "companies in the Internet ecosystem that have a higher perch, that can see broader traffic patterns," says McNicholas.

For instance, by picking up and sharing information from Internet service providers that provide Web access to wide geographic areas, ISAC members can detect many more threats than they could on their own. "ISPs can see traffic going across the network and can spot patterns of malicious traffic and isolate it faster than individual companies can," McNicholas notes.

"Likewise, individual companies that might be hit by a particular piece of malware have often found it useful to compare their experiences with others in the industry and frequently discover that others in the industry have had the same problems," he adds.

Holding Back

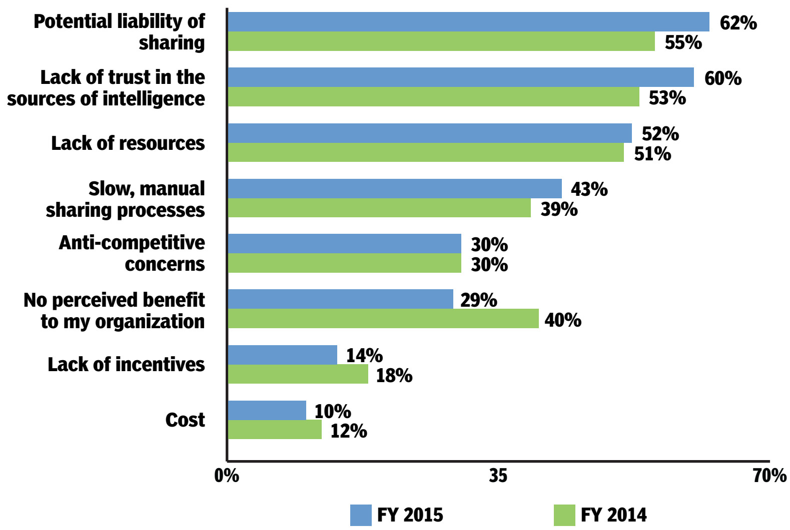
Outside the realm of ISACs, two cybersecurity firms are joining together to share information in the hopes of providing their clients with a more comprehensive defense against hackers. In January, Proofpoint, a firm that sifts through corporate emails to catch hackers, and Palo Alto Networks, which builds firewalls, launched a partnership in which they would be "sharing data in real time" to make each of their products more effective, says Paul Auvil, Proofpoint's CFO.

Neither firm's product is "infallible," Auvil explains. "You need a combination of knowledge about the email sender and about the network URL link to effectively identify and block an attack."

Yet while such targeted approaches may be paving the way for cyber-information sharing across the economy, companies are holding back from that final step for two legal reasons: the fear of being sued for mishandling cyber-threat information, or being charged by the government for price fixing.

REASONS FOR RESTRAINT

If your organization only partially participates in a program to exchange threat intelligence, what is keeping it from full participation?



Multiple responses allowed
Source: Ponemon Institute Cyber Threat Study, November 2015

CISA appears now to have removed those final barriers. If companies comply with its provisions, the law forbids lawsuits against companies based on their monitoring of information systems or sharing indications of a cyber threat.

Under its section on antitrust exemptions, the law also states that "it shall not be considered a violation of any provision of antitrust laws for 2 or more private entities to exchange or provide a cyber threat indicator or defensive measure, or assistance relating to the prevention, investigation, or mitigation of a cybersecurity threat, for cybersecurity purposes."

Yet, while those advantages seem clear enough, actual technical and legal compliance with certain provisions of the act may end up being a hard slog. One sticking point in particular may be "the removal of certain personal information before it's shared with other entities," according to Stephen Lilley, an associate at law firm Mayer Brown.

For one thing, a company must determine what a "cyber threat indicator" is within the meaning of the law—a definition that's already giving some attorneys fits. And then it must remove "any information not directly related to a cybersecurity threat that the entity knows at the time of sharing to be personal information," according to the act.

"Companies will need to think quite carefully about how they go about removing personal information consistent with the bill," says Lilley.

The company won't need to remove that information if it is directly related to a cybersecurity threat, however. For example, if companies have identified a malicious file that can be identified by a filename that's the name of an actual person, they won't have to remove that name, according to the attorney. CFO

DAVID M. KATZ IS A DEPUTY EDITOR OF *CFO.*

Reversing The Aging Process

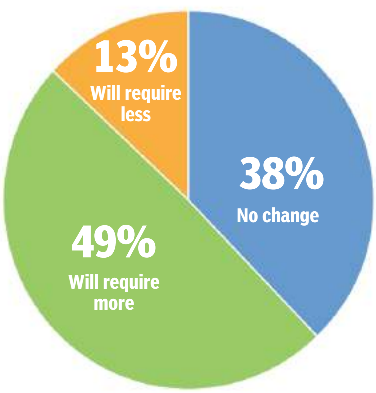
When it comes to capital investment in plant, property, and equipment, age is more than just a state of mind, according to a recent Duke University/*CFO* Magazine survey. By David W. Owens

According to the most recent Duke University/*CFO* Magazine Global Business Outlook survey, U.S. executives see their companies in something of a holding pattern, generated by uncertainty and slippage in a number of large economies around the world. But, in contrast to the widespread paralysis that accompanied the fall into the Great Recession, today's executives are not flinging their hands up in despair. Instead, they are taking a hard look at their aging asset bases and deciding where to invest for the future.

Of course, CFOs are not about to let their companies go on spending sprees right now. In the fourth quarter of 2015, 41% of U.S. respondents said they were less optimistic about economic conditions compared with the third quarter. And although their confidence in the prospects for their own companies remained strong compared with other regions of the world, it showed no improvement from the third quarter, coming in at 65.9 on a scale of 100.

FIGURE 1

Going forward, how will your company's need for capital investment change?



This wariness may help account for the fact that U.S. executives expected the average increase in capital spending over the next 12 months to be 2.6%, down from projections that were close to 6% in the first half of 2015. As a respondent from the financial services sector wrote, his company was "[choosing] to hold cash or buy shares rather than spend on investments in this environment."

But other executives thought differently and felt their companies should indeed be positioning themselves to start spending again. In fact, approximately half (49%) of the survey's U.S. respondents said that their companies needed to be thinking about ramping up capital investment. That was a little less than four times the number of U.S. respondents (13%) who thought their companies would require less capital investment going forward. (See Figure 1.)

As one manufacturer commented in regard to the need for additional capital investment, "If you're not growing, you're dying." Most executives in the survey were not willing to give up the ghost quite yet, despite their apparent disappointment in the sluggish pace of economic and business recovery.

39%

Percentage of U.S. finance executives who say their companies' aging asset base is a drag on productivity

REJUVENATING THE ASSET BASE

In part, the need to make additional investment is the natural result of the inability to do so during the recession. In explaining why his company would be spurred into new capital investment, a survey respondent wrote, "Deferred capital spending during lean years leaves a growing need to reinvest in physical assets."

A majority of U.S. respondents pointed to similar concerns, with 54% reporting that their companies' fixed assets had aged relative to five years ago. (See Figure 2.)

So now may be the time to start addressing the problem. Many of the respondents indicated they were reviving their growth ambitions—or at least not abandoning them. An executive from the manufacturing sector indicated a forward-looking perspective when writing that more capital investment was required to get the company ready for "eventual growth after [the] current downtrend." Simply put, wrote another executive from a manufacturing company, "growth is not scalable now without more capital spending."

The good news is that finance and corporate executives in U.S. companies are confident that theywill be able to handle the challenges presented by a gloomier outlook for the global economy. They are more inclined to build up their companies' core capabilities than revert to another round of cost cutting simply to keep their corporate heads above water.

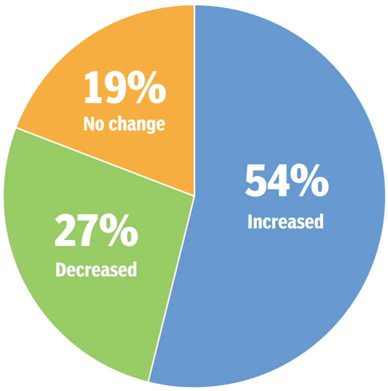
The devil, of course, is in the details, and different companies will be pursuing different avenues for investing in their futures.

SPENDING IN PLACE OF HIRING?

Some companies will be turning more to capital investment to overcome ongoing difficulties in hiring. Despite unemployment rates returning to levels that can be considered normal, finding and maintaining qualified employees remains one of the top concerns for U.S. respondents—just behind economic uncertainty and the rising costs of benefits.

FIGURE 2

Considering the normal aging of your assets and your rate of investment in new assets, how has the age of your fixed assets changed relative to five years ago?



As an executive from the mining/construction segment of respondents wrote, "We need better equipment that works more efficiently; each labor dollar spent must be more productive. The inability to hire and retain employees means technology must take the place of workers." Four in 10 respondents (39%) agree, viewing their companies' aging asset base as a drag on productivity. (See Figure 3.)

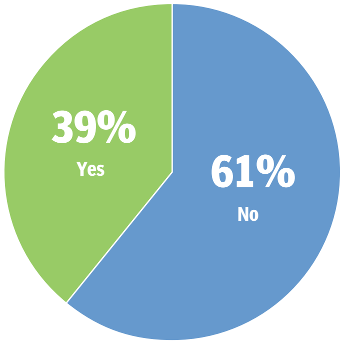
Especially in industries that may have deferred investment because of the sluggish economy, it is becoming critical to start thinking ahead. "Our plant equipment is aging, and new equipment is just now hitting the market," said an executive from the manufacturing sector. "We will need to invest quickly over the next few years to maximize the productivity gains." Another executive from manufacturing wrote that his company would require new capital investment "to increase production efficiency, as machines will replace people."

In a previous Business Outlook survey (third quarter of 2014), half of all the companies surveyed reported that they had already implemented, or soon would implement, labor-saving technology, such as robots. These technologies would allow them to maintain production but with fewer employees. Among the companies making those kinds of investments, the average reduction in the needed number of employees was approximately 10%.

However, not all of the new capital investment will be directed simply at reducing headcount. Depressed outlooks for economies in other parts of the world may also mean that U.S. companies are bringing more production back home. This would further boost the need for capital investment, as pointed out by the executive from the Q4 2015 survey who wrote that his company would be "adding more automation in order to on-shore manufacturing and still remain price competitive."

FIGURE 3

Is the aging of your fixed assets a drag on your productivity growth?



Even in what are considered "asset-light" industries, the need remains for additional capital investment. In many cases, the need is for technology required to adapt to evolving business models. A respondent from the financial services sector wrote, "Growth requires facilities expansion and greater investment in technology, which is also driven by more technology-oriented delivery of our products and services."

Another noted that "business [is] requiring better data, so more technology spending will be required." Still others pointed to the advent of new technologies, such as 3D printing, as the impetus for new capital investment.

Whether it's to modernize plants, lay the groundwork for future growth, or take advantage of technological capabilities to operate more efficiently, U.S. finance and corporate executives appear poised to address the challenge of an outdated and aging asset base. The motivation to do so lies in their determination to overcome a sluggish global economy and the resulting fierce competition for reluctant markets. CFO

Cashing In on Insight

A recent report from CFO Research documents the value that faster, more accurate cash reporting and forecasting has for growth ambitions.

By Chris Schmidt and David W. Owens

63%

Percentage of finance executives who say it's more difficult to manage cash now than it was five years ago.

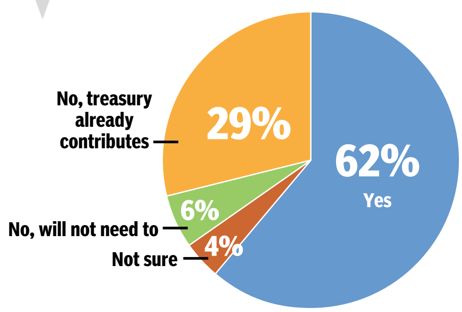
Cash management and forecasting are more difficult than ever, but they are more important than ever as well. Increasingly, companies recognize that improving the speed and accuracy of cash reporting and forecasting can catalyze growth. In turn, this recognition is putting pressure on treasury functions to be "best in class."

These are key themes from a CFO Research study of finance and treasury leaders from large companies around the world. The study, sponsored by SAP, surveyed 371 senior executives from finance and treasury departments at companies with a minimum of $250 million in annual revenues.

Large majorities of the executives surveyed believe that for their companies to succeed in the future, management outside of treasury will need a better understanding of the company's cash position and forecasts, both across all groups and business units (83% of respondents agree) and for their own individual functions or businesses (82% agree). Keeping the information within the confines of the treasury function itself undercuts the value of the data to the company at large.

FIGURE 1

"Over the next two years, do you believe that your company's treasury function will need to contribute more to high-value planning, analysis, and decision-support activities than it currently does?"



Percentage of respondents
Percentages may not add to 100%, due to rounding

Consequently, the treasury function will need to be even more involved than before with their business colleagues. Six out of 10 respondents (62%) say that the treasury function will need to increase its contribution to high-value planning, analysis, and decision-support activities over the next two years. Only 6% say that they don't believe treasury needs to contribute to high-value activities. (See Figure 1.)

And speed is a factor as well. Eight out of 10 respondents (80%) are looking for their treasury function to prepare cash reports and liquidity forecasts much more quickly than they are currently able to.

PRIORITIES FOR ACTION

A large number of finance executives in the survey say that their companies' top priorities include cash management activities—improving the accuracy, consistency, and quality of cash data (34%); improving the accuracy of cash forecasts (34%); and providing real-time access to consolidated cash information and analyses (33%). (See Figure 2.)

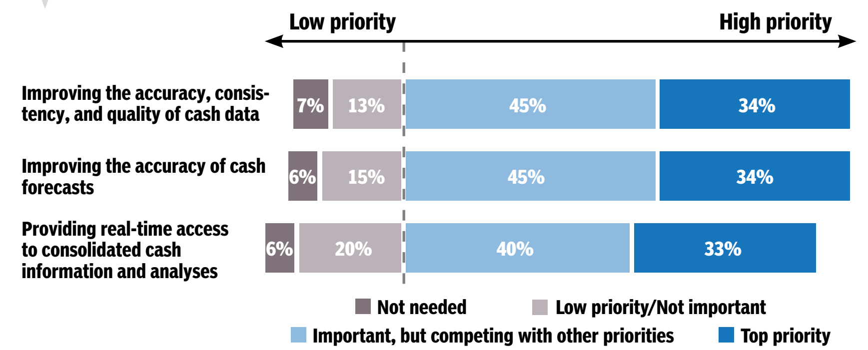
However, one difficulty is simply giving cash management the attention it deserves. As Figure 2 shows, even larger numbers of respondents rate improvements in each capability as important, but these capabilities are also competing with a company's many other priorities.

Managing conflicting priorities was a common theme among respondents. Nearly 6 in 10 (58%) say that their treasury function is under-resourced and will require additional resources over the next two years, and an even larger number (72%) say that their company's treasury function is now under more pressure than ever to reduce its costs. And these challenges are only going to intensify, respondents say.

So the ability to "do more with less" may go a long way toward maximizing the value that treasury can provide to other business managers. At the minimum, simply spending less time wrestling cash data from all of a company's separate accounts and business units can translate into spending more time adding value to cash analyses and forecasts.

FIGURE 2

"How important for your company's success are the following types of improvements to its cash-management and forecasting capabilities?"



Percentage of respondents
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THE COMPLEXITY CHALLENGE

A majority of finance executives (63%) say that, compared with five years ago, they now find it more difficult to manage cash efficiently and effectively.

For some respondents, company success is part of the problem. More than 6 in 10 (62%) say that the size and complexity of their own companies make it difficult to develop accurate views of the company's cash position and forecasts across all groups and business units. Increased complexity can also come from having more legal entities, more complex businesses, more complex product lines and selling behaviors, an increasing number of operating geographies, or all of the above.

And more than 8 in 10 (83%) conclude that increasing complexity in their businesses has made it more difficult to manage cash efficiently and effectively. Specifically, 57% say that the number of different information systems in use at their companies makes it difficult to develop accurate views of cash positions and forecasts across all their groups and business units. Looking forward, three-quarters (76%) believe that business complexity is likely to get even worse over the next two years.

PAIN POINTS

More than 6 in 10 (63%) rate complexity of the company's business as either a substantial or a moderate obstacle; the same number (63%) say that increased regulatory pressure presents obstacles; and 58% believe that it takes too much time and effort to collect data from across the company's accounts and prepare accurate cash reports.

In addition, two-thirds of respondents (66%) agree that developing accurate views of the company's cash position and forecast across all groups and business units already requires an excessive amount of manual intervention. But few of the executives surveyed currently have real-time response capabilities in place—that is, interactive, self-service interfaces—for either aggregating cash balances (12%) or preparing consolidated cash forecasts (8%).

One-quarter of the respondents (25%) report that it takes approximately half of a business day to aggregate cash balances from their global bank accounts, and even more (30%) say it takes one full business day or longer. Similarly, 23% report that it takes approximately half a business day to prepare a consolidated cash forecast, while the largest number—43%—say it takes one full business day or longer.

SPEED OF THOUGHT

In sum, respondents feel that time spent on simply collecting, conforming, and preparing cash data comes at the expense of providing additional insights and expertise from the finance function that can support better decision making throughout the company and drive growth.

Most believe that leading technology is a key enabler of making the shift to higher-value analysis. However, most respondents (56%) also believe their company's information systems and tools for cash management are only "adequately" equipped to accommodate Big Data—that is, much larger and unstructured data sets. And one in five (21%) believes their systems are less than adequate.

To provide the high-quality cash analyses at the speed required for success, companies must find new ways not only to get faster—by reducing the time and effort it takes to prepare and deliver cash reports and forecasts—but also to get better, by delivering more insightful, more immediate, and more forward-looking cash analyses into the hands of the business's decision makers.

In an increasingly difficult business environment, real-time response capabilities will allow a company to operate at "the speed of thought" and provide a crucial competitive edge. Coordination and alignment across the business will be needed to optimize decision making, and treasury functions will be called on to deliver accurate and comprehensive cash information into the hands of the managers making business decisions almost immediately. CFO

Crime Watch

Every two years, Big Four accounting firm PwC conducts a global survey of economic crime. For the 2016 edition, PwC surveyed 6,337 participants in 115 countries. The good news is that, for the first time since the global financial crisis of 2008–09, the incidence of economic crime has decreased, albeit by a scant 1%. To learn more about the state of white collar lawlessness, take our quiz.

1 What percentage of organizations has experienced economic crime since 2014?

A. 22%
B. 31%
C. 36%
D. 44%

2 The most pervasive economic crimes are shown below. Rank them in order of their incidence:

A. Bribery & corruption
B. Cybercrime
C. Asset misappropriation
D. Procurement fraud

3 The regions with the highest reported incidence of economic crime are shown below. Rank them in descending order:

A. Africa
B. Eastern Europe
C. North America
D. Western Europe

4 Three of the four types of economic crime below decreased between 2014 and 2016. Which type *increased?*

A. Cybercrime
B. Bribery & corruption
C. Accounting fraud
D. Procurement fraud

5 The economic crime with the *lowest* incidence was:

A. Tax fraud
B. Insider trading
C. Mortgage fraud
D. Espionage

6 Which industry was most at risk, with 48% of organizations reporting economic crime?

A. Retail & consumer
B. Financial services
C. Government/state-owned
D. Transportation & logistics

7 The industry sector with the biggest rise (9%) in the incidence of economic crime was:

A. Transportation & logistics
B. Aerospace & defense
C. Energy, utilities & mining
D. Financial services

8 What percentage of organizations suffered losses of more than $1 million from economic crime since 2014?

A. 5%
B. 10%
C. 14%
D. 19%

Answers: 1-C; 2-C, B, A, D; 3-A, D, C, B; 4-A; 5-D; 6-B; 7-B; 8-C

Source: PwC Global Economic Crime Survey 2016

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