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Team Trump's Tug-of-War

Taming Health-Care Costs

Green Reporting Takes Root

Investors press issuers for meaningful environmental and social disclosures


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YARDS
ACCURACY
64.22%
114
MPH
SPIN 2,154 RPM
14°
SMASH FACTOR
1.50
SPEED 165 MPH
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Cover: Getty Images; clockwise from top left: Thinkstock (2)

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By the Numbers

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FROM THE EDITOR

Eroding Efficiencies

›› "Stock market efficiency eroding as more money is allocated bluntly by ETFs," a recent sub-headline in the *Financial Times*, got me thinking about what an increase in exchange-traded fund ownership means for issuers. It's not an academic question, because, according to Sanford Bernstein, by January 2018 more than 50% of equity assets under management in the United States will be passively managed.

The question is also on my mind because our cover story, "Green Reporting Takes Root," by deputy editor David Katz, deals with active investors pushing companies for sustainability disclosures in financial statements.

Why does an increase in passive investing matter? In a study mentioned by the *FT*, "Is There a Dark Side to Exchange Traded Funds? An Information Perspective," researchers found that a one-percentage-point increase in ETF ownership increases correlation to the company's industry and the broader market by 9%. What's more, the relationship between share price and future earnings slips 14%.

Nicholas Colas, chief market strategist at ConvergEx Group, wrote about this years ago in relation to index funds: "When capital flows to a company for no other reason than it is in an arbitrarily created index, the purest function of markets—allocating capital to its best possible use—will by necessity not work as well. ... Money that goes into an indexed product will be put to work across the board, not into the sectors and companies that offer the best risk-reward."

A lot more research is needed to determine if, indeed, markets have truly become less efficient and less responsive to company fundamentals because of the rise in ETFs. But CFOs need to be aware of this dynamic.

A market where outperforming industry peers isn't rewarded would sap the motivation of any public company CFO. It would also surely further reduce the number of companies that want to go public. Passive investing has a role to play, but here's hoping active investors endure.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

FINANCE

It's not to early to think about reserving your place at CFO's Treasury and Risk Management Summit, taking place September 7-8, 2017. This year's speakers include the treasurers of MasterCard and Toys R Us, and the head of derivatives at Fluor. Learn more at https://theinnovationenterprise.com/summits/treasury-management-summit-boston-2017.

STRATEGY

In "Pushing Manufacturing Productivity to the Max," three McKinsey consultants describe how a metric termed "profit per hour" can provide a "more exact view of fluctuations in the operating environment" and give CFOs a more timely view of actual profits versus forecast. Read more at http://www.mckinsey.com/business-functions/operations/our-insights/pushing-manufacturing-productivity-to-the-max.

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Mark Bennington

THE BUZZ ON CFO.COM

Each month, CFO.com presents a forum called "Square-Off," where several expert contributors opine on the best answer to a debatable question. In April we asked, **"Is Executive Pay Too Low, Too High, or Just Right?"**

Contributor Brandon Rees, an official with the AFL-CFO, wrote in his article, "High CEO Pay Is Bad for Investors and Companies," that the CEO pay ratio rule is "material information for investors, providing insight into companies' human capital management strategies."

The rule, under which a company must report the ratio between the compensation of its chief executive and that of its median-paid employee, has come under fire from many directions. "I dislike the distorted CEO pay ratio," commented one audience member. Still, he agreed with the sentiment that brought the rule into being.

"As a compensation expert, I agree that boards and compensation committees have gotten out of control," he wrote, identifying as a key issue the practice of using the pay of CEOs at peer-group companies as a benchmark.

He further suggested that neither compensation committees nor the consultants they hire **can be trusted to be independent actors in the setting of executive pay.** He concluded, "The AFL-CIO should be advocating for the multi-stakeholder model, and let go of all the ISS/shareholder drivel," referring to the shareholder advocacy group's insistence that shareholder concerns are the overwhelming issue where executive compensation is concerned.

Compensation consultant Marc Hodak of Farient Advisors contributed to the package with "Like Top Actors, Good Execs Are Paid for Value Generated." He wrote, using Jennifer Lawrence as an example, "What are the customers buying? A young woman dressing up in costume and reading lines written by others while emoting."

He went on, "If Jennifer Lawrence is worth $50 million … how far do we really have to stretch credulity to believe that the leaders of the largest multinational corporations, managing tens of billions in assets and employing hundreds of thousands of people, might be worth $15 million, the average income of an S&P 500 CEO?"

For one reader, it was Hodak's point of view that stretched credulity. CEO pay is "way too high," he wrote. "There are many people who could produce the same for less."

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STATS OF THE MONTH

HIGH ENERGY

9.13 million
Projected barrels-per-day production of U.S. crude in 2017

16
Number of weeks in a row there has been an increase in active U.S. rigs drilling for oil*

1.65%
Projected year-over-year increase in worldwide oil consumption in 2017

-$11.76
Two-year decrease in NYMEX crude oil price*

*As of May 22, 2017
Source: Energy Information Administration

Topline

AUDITING

Higher Pay, Fewer Restatements

The more a Big Four firm pays its auditors, the fewer restatements its clients have, finds a new study.

The offices of Big Four accounting firms that pay lower salaries for audit help have a higher proportion of clients that experience restatements, according to a new study.

"We obtained a sample of data on how much Big Four accounting firms are paying their auditors, and found that, controlling for the type of office, city, and a whole host of other factors, the more an audit firm pays its auditors, the fewer restatements you get in an office," Jeffrey L. Hoopes, an assistant professor of accounting at the University of North Carolina and a co-author of the study, tells *CFO.*

"In other words, you get what you pay for. While this result may seem intuitive, it has not been documented in large samples previously," Hoopes contends. "It seems a truism, but it's surprising to me that it hasn't trickled down and resulted in firms paying more" for audit help, he says, noting that firms are paying more for consulting, tax, and information systems work.

Basing their study on a sample of about 13,000 salaried Big Four employees during the period from 2004 to 2013, the researchers find that the average associate earns $54,356 per year, while seniors and managers earn substantially higher average salaries of $71,663 and $86,730, respectively.

"While salaries have risen from 2004 to 2013, we find that inflation-adjusted salaries have remained stagnant, and in some cases, have actually declined," the authors write.

Across the audit firms in the sample, KPMG seems to have paid the highest average salary ($67,618 per year), while Deloitte paid the lowest ($62,467). KPMG appears to have paid the highest individual salaries ($97,538) for audit managers.

Hoopes notes that some observers might argue that staff auditors don't sign up at a Big Four firm for the money. Rather, they sign on for the experience, hoping to apply that experience at a different job later. The study data suggests, however, "that paying a little more may indeed attract higher quality folks that do a better job auditing," Hoopes says.

The idea of paying entry-level audit help more attractive salaries may be anathema to some audit partners, Hoopes says, recalling a conversation with a partner at a Big Four firm in Detroit at the height of that city's economic woes. The partner was having trouble attracting quality candidates to Detroit. When Hoopes suggested paying higher salaries, "the partner stared at me as if I had spoken some great heresy," Hoopes says.

The study examines the relationship between audit personnel salaries and office-level audit quality. It gauges audit personnel salaries at the associate, senior, and manager ranks for Big Four audit offices using data obtained from the U.S. Department of Labor.

"If you want a good audit, make sure your auditors are well paid."
—Jeffrey L. Hoopes, University of North Carolina

"We find that offices that pay lower salaries have a higher percentage of clients that experience restatements. In related analysis, we also find lower levels of audit quality when audit employees are paid less relative to other lines of service in accounting firms," Hoopes says.

The takeaway for CFOs? "If you want a good audit, make sure your auditors are well paid," Hoopes says.

Prior research has not examined the implications of audit personnel salary for audit quality because auditor salary information is not readily available, the authors contend in the paper.

The researchers overcame that data limitation by using about 13,000 publicly available worker visa applications provided by the U.S. Department of Labor, as a proxy for the salaries offered to audit personnel across 185 local U.S. offices of Big Four audit firms.

Besides Hoopes, the co-authors of the research paper are Kenneth J. Merkley, Cornell University, and Joseph Pacelli and Joseph H. Schroeder, both of Indiana University. **DAVID M. KATZ**

CAREERS

Clicking with CEO Most Important

New research suggests that, from a CFO's point of view, failing to meet financial goals is nowhere near the surest way to get bumped from the role.

Executive recruiter Korn Ferry asked 321 CFOs to identify the top reason a company would choose to switch to a different finance leader. Only 8% of them pointed to "not meeting the company's financial goals."

Instead, relationships were thought to be far more important, with 55% of respondents saying they'd most likely get booted from the role if they had a poor working relationship with the CEO or the board of directors (41%), or if they had personality issues or weren't able to work well with or lead others (14%).

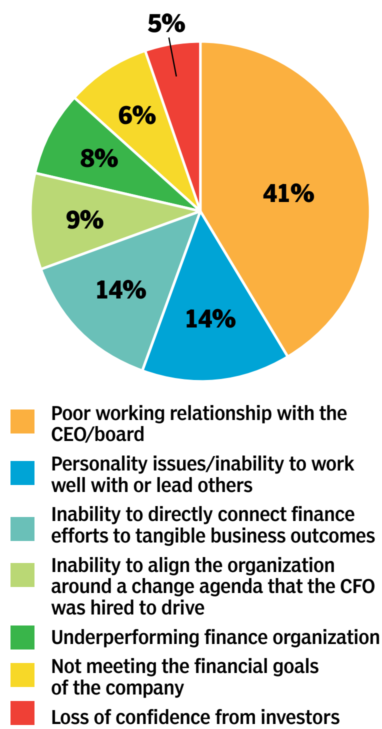
"This proves that the CFO role is about much more than profit or loss," says Bryan Proctor, a senior client partner at Korn Ferry and global leader of its financial officer practice. "It's about helping lead the strategic trajectory of an organization for overall success and developing the required relationships."

But if there were a poor working relationship with the CEO, most finance chiefs wouldn't hang around waiting for the ax to fall. More than half (52%) of those surveyed cited it as the number-one reason they'd voluntarily leave a company.

When considering what's next for their careers, a third of the CFOs said their desired next move is to become a CFO of a larger company. Nearly a quarter (23%) said they would like to be a CEO in their next role, but only one-third of those either agreed or strongly agreed that they are a likely successor to the CEO at their current company.

As for what type of experience they most need to gain in order to become a CEO, the top responses were commercial experience (30%), industry depth (27%), and operational experience (25%). **DAVID McCANN**

What is the top reason a company would look to change its CFO?



Source: Korn Ferry

Opposite, Thinkstock; This page, courtesy Jeffrey Hoopes

AUDITING

PCAOB to Select Audits Randomly

While there's no evidence that audit firms can predict which audits the Public Accounting Oversight Board will choose to inspect, the PCAOB is taking steps that will limit the chance that a firm could manage to the risk of the inspection process.

In remarks before the annual Baruch College Financial Reporting Conference in early May, PCAOB board member Jeanette M. Franzel revealed that the board is embarking on a "randomization" project that goes beyond selecting audits for inspection based on risk. "In recent years, we've been adding some non–risk-based selections and random selections to the mix of inspected audits," Franzel said.

Later in her talk Franzel said that "incorporating an element of randomization may increase audit quality by limiting the ability of firms to predict—and therefore, potentially seek to game—which of their audits the PCAOB may select to inspect."

Franzel said the randomization project was designed to provide a broader, more accurate picture of overall audit quality across the industry, and, especially, at the Big Four audit firms. She said the PCAOB's Center for Economic Analysis (CEA) has been working with the Division of Registration and Inspections to apply "statistical methods throughout the selection process and analysis of inspection results."

This is a definite shift from what the PCAOB has done in previous years. As Franzel explained to the audience, "individual audits and audit areas selected for inspection are generally selected on a risk-weighted basis," and "areas of focus often involve audit work on the most difficult or inherently uncertain areas of financial statements."

But now the PCAOB is looking for a more complete picture of audit quality, to get a "statistically generalizable result," Franzel said. **VINCENT RYAN**

FINANCIAL REPORTING

'Other Reporting' Brings Risks

When the Securities and Exchange Commission released staff guidance a year ago about reporting non-GAAP financial measures, issuers were advised to review disclosure controls and procedures to ensure they adequately addressed the use and presentation of non-GAAP financial measures.

Now, with issuers largely falling in line with non-GAAP guidance, SEC Chief Accountant Wesley Bricker is trying to draw issuers' attention to integrity issues in another area of financial reporting: the disclosure of supplemental information like operating metrics and forecasts.


Wesley Bricker

At the Baruch College Financial Reporting Conference, Bricker placed particular emphasis on controls and procedures around "other reporting," noting that as companies move beyond non-GAAP measures to report supplemental information investors are keen on, they have to be wary.

"Similar to non-GAAP financial reporting, key operating metrics and forecasts may also be distorted via bias—for example, painting a potentially misleading picture—error, or fraud, all of which undermine the credibility of the reporting," Bricker said. "Therefore, it is important that companies proactively and thoughtfully address risks to their reporting."

How should companies go about it? "Companies should first understand the other information being reported, including how operating metrics are defined," he continued. "Companies then should have adequate disclosure controls and procedures in place. In some respects, these other reporting processes may require *more* steps than some GAAP processes."

The challenge for issuers is that there are no standards for reporting this kind of information. "A company's other reporting does not have the benefit of standard-setting due process, which solicits stakeholder views on a representationally faithful manner of reporting a particular event or transaction and the types of disclosures needed by financial statement users," Bricker explained. **V.R.**

Thinkstock, courtesy the SEC

INVESTOR RELATIONS

Do Shareholder Reactions Drive Results?

A new study offers fresh evidence that companies may manipulate their financial results in response to investor behavior.

The American Accounting Association research, which studied 6,836 public companies over 16 years, measured the market's sensitivity to quarterly revenue and earnings results. For each company in each quarter, the study calculated two metrics to reflect such sensitivity: revenue response coefficient and earnings response coefficient. RRC represents the degree to which stocks rise and fall in response to the disparity between analysts' revenue forecasts and actual performance, and ERC represents the same with regard to earnings.

The study showed that in quarters immediately following those when RRC was above the median for all studied companies, 16% of firms reported revenue that barely met or slightly exceeded analysts' forecasts. In contrast, only 9% of firms did the same following quarters of below-median RRC.

Following quarters of low ERC, 15% of the companies reported revenue that barely met or slightly exceeded analysts' revenue forecasts. Only 11.5% did so following quarters of high ERC. In other words, it appears that when investors react to revenue announcements, revenue in the following quarter is more likely to align with analysts' revenue forecasts.

"Corporate managers are attuned to what investors are looking for in their companies' reports and to the weight investors assign to revenues as distinct from earnings," says Rong Zhao, an assistant accounting professor at the University of Calgary, who performed the research. "And to a considerable degree, the revenues they report reflect this." D.M.

REGULATION

Former SEC Employee Charged

A former Securities and Exchange Commission employee has been accused of making improper trades in options and other securities and concealing his trading from the SEC's ethics office.

SEC employees are subject to strict rules designed to prevent even the appearance that they may use their public office for private gain. Among other things, they cannot trade in options and have to disclose their securities holdings to an ethics office.

According to the SEC, however, David Humphrey, 60, ignored those rules while employed as a staff accountant for the commission and later as a branch chief in the Division of Corporation Finance between 2001 and 2014.

The SEC alleged in a civil complaint that Humphrey devised and executed an "options trading strategy" under which he traded options more than 100 times on behalf of himself, his mother, and a childhood friend.

"Humphrey never sought pre-clearance [from the ethics office] for his prohibited options trades and he filed forms that falsely represented his securities holdings," Gerald W. Hodgkins, associate director of the SEC's Division of Enforcement, said in a news release.

To settle the SEC's charges, Humphrey agreed to pay $51,917 in disgorgement of profits he made on the improper trades plus $4,774 in interest and a $51,917 penalty. In a related criminal case, he pleaded guilty to making false statements in financial disclosure reports.

Humphrey began working for the SEC in 1998. Starting in 2001, he allegedly conducted an "improper" trading strategy that involved writing uncovered options against an index and occasionally an individual stock.

"Humphrey would receive proceeds, or 'the premium,' for selling the option with the hope that it would expire worthless and Humphrey would retain the premium," the SEC said. On one occasion, Humphrey also allegedly sold put options on shares of Citigroup. MATTHEW HELLER

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RISK MANAGEMENT

Corruption Is Costly—and Pervasive

Companies appear to be waking up to corruption's pervasiveness. According to the 5th Annual Anticorruption Survey by AlixPartners, more executives appear to be taking action (1) when dishonest behavior by those in positions of power is exposed and (2) beforehand, by establishing practices to prevent bribery and other malfeasance from happening in the first place.

Forty-two percent of the 300 corporate counsel, legal, and compliance officers surveyed by AlixPartners say they have stopped doing business with certain partners due to corruption risk, up from 32% in 2015. Thirty-one percent lost business due to corruption risk, up from 23% the year before, and 37% pulled out of or delayed an acquisition due to corruption risk, compared with 36% in 2015.

Executives in the AlixPartners survey also indicate that it is becoming tougher for their companies to steer clear of potential corruption. About two-thirds (67%) of respondents believe there are some geographies where it is impossible to avoid corrupt business practices: Russia (35% of respondents), the continent of Africa (33%), and China (27%) top the list.

As a result, companies have adopted more controls and compliance policies in recent years, according to AlixPartners. A higher percentage of companies today have implemented a dedicated anticorruption program in the past 10 years (60%) and 76% have reviewed their policies within the last year (up from 67% in 2016).

What methods are companies finding most successful at mitigating corruption risk? Internal audits and anticorruption compliance policies take the lead for survey respondents, at 84%. For 81% of respondents, training is also considered effective. **V.R.**

Revenue Recognition: Disclosure Can't Wait

FASB's revenue recognition standard includes complex disclosure rules that many companies are ignoring. By Eric Knachel

As companies scramble to implement FASB's revenue recognition standard, many are primarily focusing on the high-profile revenue and measurement requirements. Meanwhile, many companies are largely ignoring the new disclosure requirements, treating them as a minor detail that can be quickly and easily addressed once the other requirements have been satisfied. That's a mistake.

A common misconception is that revenue disclosures are just like "showing your work" in math class—i.e., simply documenting whatever calculations you made to arrive at the revenue numbers. But the disclosure requirements actually involve much more. Continuing the math class analogy, it's as if your teacher isn't just demanding that you show your work, but also that you write an in-depth essay explaining the approach you chose, why you chose it, what assumptions you made, what tools you used, and what processes you followed to ensure nothing would go wrong.

FASB's new standard significantly increases the amount of information companies are required to disclose about their revenue activities and related transactions. To comply, a company will likely need new processes, procedures, and controls for: (1) gathering data, (2) identifying applicable disclosures (based on relevance and materiality), and (3) preparing and reviewing disclosures and related information. It will also need information systems and personnel to support disclosure-related activities. Establishing and testing all of these elements will likely require significant time, money, and effort.

Although for many companies the new disclosure requirements don't take effect until 2018, that doesn't mean they can wait until the end of next year to deal with them. This is particularly true for public companies registered with the Securities and Exchange Commission.

Under normal circumstances, comprehensive disclosures are generally reserved for annual reports, while quarterly reports are viewed as interim updates to the previous year's annual report and are therefore much less detailed. However, because FASB's new revenue standard is not currently in effect, this year's annual reports will not include the newly required disclosures. Instead, those disclosures will need to be covered fully in next year's first quarter report.

This could present some major challenges, since many companies already struggle to meet their filing deadlines. Add in the time and effort required to satisfy the new disclosure requirements—along with the potential for problems and delays in collecting, preparing, and reviewing disclosures and related data—and the result could be late filings, internal control implications, or both.

Danger Zones

To illustrate the complexities and potential problems that can arise, here is a quick look at some of the more challenging revenue-related issues affected by the new disclosure requirements:

• Performance obligations. Companies are required to disclose the portion of a transaction's price that is allocated to "remaining performance obligations" (terms of the contract that have yet to be satisfied), and then explain when in the future the company expects to recognize the revenue associated with those unsatisfied obligations. For some companies, this may require estimates that extend years into the future.

• Significant judgments and estimates. Companies are required to disclose information about the methods, inputs, and assumptions they used to both (1) estimate the amount of "variable consideration" (rebates, performance bonuses, refunds, etc.) included in the transaction price, and (2) estimate the likelihood of significant revenue reversals when the uncertainty associated with some or all of the variable consideration is resolved.

• Changes in contract asset and liability balances. Companies are required to disclose and explain changes in contract asset and liability balances that occurred during the reporting period. Examples of such explanations include: changes due to business combinations or dispositions; impairment of contract assets; contract modifications; changes in the estimate of transaction price; and variations in expected progress.

• Out-of-period revenue adjustments. Companies are required to disclose revenue that is being recognized in the current reporting period but resulted from performance obligations that were satisfied in a previous period (due to changes in the transaction price, revision of variable consideration estimates, etc.).

Tackling the Challenge

As a company analyzes each disclosure requirement, there are a broad range of factors to consider, including: materiality, relevance, the specific information that will be needed (and how to get it), and which controls will be necessary to prepare and review the disclosures and related underlying data.

Some of the information required to comply with various disclosure requirements will likely be similar—or come from similar sources. For example, disclosure information related to performance obligations may overlap with disclosure information related to estimates of variable consideration. As such, companies should strive to develop comprehensive strategies for collecting information without gaps or wasteful duplication. Such a strategy will help a company create disclosures that tell its revenue story both efficiently and effectively. CFO

Eric Knachel is the senior consultation partner for revenue recognition in the national office accounting services of Deloitte & Touche LLP.

Is 'Inventory Lite' Coming to An End?

Can companies find enough efficiencies to continue the 15-year surge in cash flow?

After 15 years of great success in boosting its operating cash flow via "inventory lite" strategies, corporate America may be reaching the limit of how much cash it can generate via working capital management. And if profits continue to remain sluggish, CFOs will find their companies unable to offer shareholders the big dividends and buybacks they've been dishing out in recent years, according to Charles Mulford, a Georgia Tech accounting professor. Mulford, along with graduate research assistant Sarika Misra, is the author of a new study on corporate cash generation.

Driven by an "inexorable decline in inventory" between 2000 and 2015, the median operating cash flow generated by U.S. nonfinancial companies soared by a whopping 391.8%, according to the study.

To be sure, operating cash flow is affected by changes in revenues and costs. But it's also affected by changes in operating-related working capital measurements including accounts receivable, inventory, and accounts payable. In the case of inventory, when the costs of maintaining it decrease, operating cash flow rises.

For a decade and a half, companies have been doing a good job of "pushing [their] inventory needs off onto their vendors," Mulford says, thereby creating a situation in which companies get the goods they need almost exactly as soon as they need them.

The problem is that the ability to increase operating cash flow by slashing inventory may have reached its limit.

"There is some inventory number out there that is an absolute minimum," Mulford says. "I think we're getting pretty close."

From the finance perspective, that would mean there are "fewer levers that CFOs can pull than they had in the past" to improve working capital performance," he notes.

Over the 15-year period, there was only an 83.5% rise in revenue, according to the study of 3,800 nonfinancial U.S.–based publicly traded companies. Thus, the bulk of the nearly 400% rise in operating cash flow had to come from somewhere other than sales. Between December 2000 and December 2015, "inventory days continued a relentless decline, dropping 29.7% from 22.53 median inventory days to 15.85 days," according to the report. ▸ DAVID M. KATZ

Thinkstock (2), courtesy Deloitte & Touche LLP

Simplifying Planning Season

Corporate performance management software helps the Tampa Bay Rays forecast more efficiently. By David McCann

Growing up in Philadelphia, Rob Gagliardi did what all baseball fans there do: he bled Phillies red. So it was "kind of surreal," Gagliardi says, when, only a year after he landed a job as vice president of finance for the Tampa Bay Rays in 2007, the team had its first winning season and wound up in the World Series—where they lost to the Phillies.

Any mixed feelings he may have had were prioritized. "You quickly realize where your paycheck is coming from," says Gagliardi, who became the Rays' CFO at the beginning of 2015.

After the World Series appearance, the team made the playoffs three more times from 2010 to 2013. When the team is in a playoff run, ticket sales remain strong all year. It can make the difference between tickets accounting for as much as 25% of the Rays' annual revenue or, during a poor season, about half that much.

Gagliardi's chief responsibility is providing the team's owners and management with the information they need to make good decisions. A key task is working up a range of financial forecasts for a particular year based on, among other factors, various team-performance scenarios. This year he's creating the scenarios more efficiently through the use of a new technology tool.

Gagliardi had been looking for software to help with scenario planning for a couple years before settling on the Adaptive Insights cloud-based corporate performance management platform. Normally, he says, he dreads April, because it's when he creates the scenarios for the year.

"It would take me a week, [during which] I'd literally shut my door and

Forecasting "would take me a week, [during which] I'd literally shut my door and put on my blinders and just devote myself to Excel templates."
—Rob Gagliardi, CFO, Tampa Bay Rays

put on my blinders and just devote myself to Excel templates," he says. Now, with the new software, the process takes only a small portion of one day.

Gagliardi first used the software to create a scenario last year. Major League Baseball's collective bargaining agreement with the Players Association was set to expire at year-end, and Gagliardi developed a financial scenario based on the possibility that MLB could lock out the players at the beginning of 2017. (A new CBA was finalized in November 2016, averting the scenario.)

Gagliardi is also using the software this year for several other financial processes, including the tracking of cash flow and the corresponding borrowings and debt covenants. Until now he's been using Excel for those tasks as well. "I have everything in [an Excel file], including our owners' income tax [information]," he says. "It's a 50-tab workbook and it's not easy to maintain."

All for One

The Rays are one of five teams that are using Adaptive Insights' software, along with the Arizona Diamondbacks, Chicago Cubs, Cleveland Indians, and New York Mets. Gagliardi and his Mets counterpart are trying to get all five together for a user-group meeting sometime in 2017.

It's likely to happen, because of the collaborative nature of baseball CFOs. "We all realize that nothing we do in terms of debits and credits can impact what happens on the baseball field," he says. "So we share trials and tribulations. A lot of us moved to paperless expense reporting. And the Rays were one of the first to use a paperless, cloud-based invoice and purchase-order product, so we've tried to spread the word on that."

In fact, it was Gagliardi's recommendation of Adaptive that got the Mets, Cubs, and Diamondbacks interested in it, he says. (The Indians had been investigating the platform separately, at the same time the Rays were.)

Gagliardi is also working with the Mets to streamline the work that baseball-team finance departments do to respond to MLB's "FIQ"—financial information questionnaire—five times per year. "It's a giant workbook that we have to populate," he says. "I've been going back and forth with the Mets, sharing ideas about how to get a report built within Adaptive to basically just spit out the FIQ. Right now, my controller spends a week just taking the numbers."

No matter what, he notes, teams will still have to do some Excel work. Baseball finance uses what he calls "quasi-GAAP," which accounts for some things differently than GAAP. "So we can't just take our numbers exactly out of our GAAP financials that we've created within Adaptive," Gagliardi says.

Some teams, he claims, make little effort to properly update the information in the FIQ from one reporting period to the next, instead catching up at the end of the year. But the Rays, as a team in one of baseball's less-lucrative markets, get a share of a revenue pool to which teams in the more-lucrative markets contribute. "As a receiver under the revenue-sharing plan, I like the other teams to have a good sense of what our true numbers are," he says.

Not a Glamour Profession

Gagliardi was exposed to sports-team finance in his prior job as a regional CFO at Comcast, which owned the Philadelphia 76ers basketball team and Philadelphia Flyers hockey team (it has since divested the 76ers).

Even Comcast's core operations as a cable company provided him with experience that's useful in his current job. "A cable company wants subscribers, and a sports team wants season-ticket holders," he says. "It's kind of similar."

"As a receiver under the revenue-sharing plan, I like the other teams to have a good sense of what our true numbers are," says Gagliardi.

But working for a professional sports team doesn't mean he lives a glamorous life. For example, he has virtually no contact with the players. Most interaction with them occurs in the years Tampa Bay makes the playoffs, in connection with the bonus money that players on playoff teams collect from MLB from a pool of post-season ticket revenue.

There may be more interaction with players soon, though. Traditionally, players pay clubhouse attendants in both their home stadiums and those that they visit to provide the food and other items the players request. But the new collective bargaining agreement provides for a higher level of food and service to be offered and paid for by each team.

"There's usually a wall between the players and the front office," Gagliardi says. "They may know my face as the head bean counter, but that's about it." Now, though, he's getting involved with both the home and visiting clubhouse operations, which means he sometimes goes into the clubhouses themselves.

Meanwhile, as is true for every major professional sports team, player salaries comprise a huge portion of the annual budget. In general terms, how much the team is willing to spend can affect its chances of making the playoffs, the incremental revenue from which hopefully will pay for any added salary expense.

"As much as everyone outside of baseball thinks all the owners are making so much money, they're really not making much from baseball," Gagliardi says. "Maybe they're getting a capital appreciation on the value of the team, [as suggested by reporting on the topic by] *Forbes*. I can't vouch for those numbers, but some owners are probably making some good paper gains."

Either way, the large sums that teams spend on player salaries is one reason why owners and management are so much in need of timely and accurate data on other financial aspects of the operation.

"I can't dictate what they spend on salaries. The baseball operations guys do that," the CFO says. "But we can give them a sense of some parameters they can play within."

There are many factors in the financial equation. For example, while a playoff contender will get more revenue from tickets, concessions, and parking, it also will take on added operational costs, such as for cleaning the stadium after games.

Sponsorship and advertising revenue is usually locked in by the beginning of the season. There can be a "lag" effect to that corporate revenue—how the team plays one season will have some bearing on how many sponsors and advertisers will get on board for the following season. On the other hand, the corporate sales team is usually selling for the next year starting in June, with more than three months left in the season.

"At the end of the day, what we do is really just roll up the numbers to help the senior management and owners understand them," Gagliardi says. "At a public company, you do the same thing for the stockholders." CFO

Courtesy Tampa Bay Rays (2)

What Kind of Value Generator Is Your Company?

Being a "unicorn" that aims for explosive growth but exhibits little financial discipline may not be the best way to create shareholder value. By Ken Stillwell

I've been working in software now for more than 15 years, and one of the most common questions I've heard is, "How do these privately held software companies achieve ridiculously high valuations when they are losing massive amounts of money?" These companies are often dubbed "unicorns" because they are thought to have magical powers—disruptive technologies that hold the potential for explosive growth. Unicorn valuations have been a hot topic in the industry, and every software startup hopes to become one someday. But the reality is that there is more than one way to generate shareholder value in software, and some methods might be better than others. Here is my take on the different business models that drive shareholder value.

The Golden Goose

The first way a software company can create shareholder value is by becoming a consistent cash-flow producer like a company such as CA Technologies. A company like this experiences low year-over-year revenue growth—not necessarily because it is poorly run, but because the markets it serves are established, mature, and have low growth. This kind of firm also delivers a product that is typically sticky with high switching costs (i.e., a product that customers really need that's hard to replace, such as mainframe computing software).

A golden goose business may also choose to do tuck-in acquisitions to offset declines from its core revenue streams. Typically, this kind of company will push operational efficiency to drive down costs consistently and improve profitability to generate cash flow each year. Shareholder value is delivered via predictable cash flows in the form of dividends and share buybacks to investors year after year.

The key risk with this alternative is that the cash generator has a shelf life, and there is often limited upside to this investment. At some point, the reduced investment in technology to achieve profit targets catches up with this model. I characterize it as being too risk averse. Hiring innovators or growth-driven managers—and keeping them engaged—is tough in a business like this. Solid operational managers thrive at a golden goose, but the culture risks being less innovative and a little too "stable."

The Unicorn: Driving Hypergrowth

A second way to create shareholder value is to deliver explosive annual revenue growth. The unicorn often grows 40% or more per year and focuses on capturing market share fast in emerging, disruptive sectors. The growth is at all costs, profit and cash flow be damned. This kind of company creates shareholder value because its revenue growth rates are highly accelerated, leading investors to believe that someday (likely many years away) the organization will make a profit and deliver cash flows. Alternatively, the investors, often venture capitalists who are fueling these fantastical beasts, bet on a future takeout (i.e., that a buyer will purchase the firm at a crazy revenue multiple).

In fact, venture capital investors have told me over the years that an early-stage company that makes money is not executing. Remember, venture capital firms expect that more of their investments will lose money than will make it, but the gamble is that those very few "home-run" investments will make up for the numerous losers. This model works very well for the venture capital industry, as well as for senior executives of the home-run companies. It doesn't work so well for the executives and employees of those companies that perform less than exceptionally. It's like 36 people placing a bet on a roulette wheel. One winner gets a 35-to-1 return; 35 losers go home broke.

Sales software company HubSpot is a great example of the hyper grower. HubSpot's revenue grew from $181 million in 2015 to $271 million in 2016, an increase of 49%. But the firm lost $44.7 million in 2016, after losing $46.1 million in 2015. In 2017, the firm's market cap is more than $2.6 billion, which shows that investors believe in the company's potential to produce future cash flows. I suspect that this view is more likely connected to cash flows from an acquisition by a larger market player.

Cisco's $3.7 billion acquisition of AppDynamics on the eve of its proposed IPO is one example. The valuation was roughly 15 times revenue. It's hard to believe that AppDynamics could have achieved enough annual cash flow as a standalone business to justify anything near a market capitalization of $3.7 billion—so they sold, as they rightfully should have. This is by far the most common outcome for unicorns. Not many become Facebook or Google and stay independent; the odds are deeply against them.

A downside to pursuing this strategy is that shareholder value realization is heavily dependent on the merger and acquisition landscape. In an economic downturn (or even in slower growth environments), the hyper grower can face many hurdles. Another challenge arises because of the hyper grower's tendency to develop a culture around rapid revenue growth and rapid spending increases with no concept of profitability. Establishing the financial discipline to maximize profitability is often difficult. In fact, the rapid-growth and rapid-spending culture can make a unicorn overly focused on driving growth at any cost and cause its decisions to be fiscally irrational.

I characterize this model as a "swing for the fences." You see the home runs advertised on the news but not the numerous strikeouts that occur. For example, FreeMarkets was valued at around $13 billion in 2001, and then sold a few years later for $500 million to Ariba after the economic climate changed.

"A downside to pursing [the unicorn] strategy is that shareholder value realization is heavily dependent on the merger and acquisition landscape."

—Ken Stillwell

Unicorn company culture is generally focused on growth, fun, beer, and candy. People typically job-hop quite a bit and are not concerned with the long-term strategy of their moves or about setting a bad precedent. The reality is that most of these companies will never survive long term as a standalone entity. Executives are hoping for a sale and likely will be very pleased with the outcome, financially. Their customers and employees? That might be a different story, depending on the buyer, the price, and the number of people and products displaced as part of the buyout.

The "Ship of the Desert"

A camel is called a ship of the desert because of its strength, resiliency, and brilliant design for its environment. A company that creates value for its shareholders by delivering scalable and predictable growth is a "ship of the desert" in the economic world.

These kinds of companies increase revenues at rates that can be consistently achieved (10% to 20% or more annually) *and* they increase operating margins as their companies scale. They focus on large, growing markets that are both durable and sustainable. These companies weather the many inevitable storms and droughts because they balance revenue growth and profitability. In many ways, this kind of company is a great option for shareholders who are looking for a predictable, ongoing return on their investments. A company in this category tends to have high customer retention rates but also possesses a competitive solution that supports existing customer expansion and attracts new customers to drive long-term revenue growth.

Executives running businesses that fit into this profile could fall into a trap. They might, by mistake, become like the companies in one of the first two categories. By either managing costs to an extreme or by shooting for unachievable hypergrowth, executives can unintentionally lose their balance and reshape the business outcome to the detriment of shareholders. From my experience, the primary driver when making this mistake is an inappropriate assessment of risk.

Companies with more of a balance tend to not hit extremes culturally, which means the workforce has stability but not complacency, energy but not mania. The challenge is to ensure there's a mix of personality profiles, including innovators, process deployers, orchestrators, and optimizers. CFO

Ken Stillwell is chief financial officer of Pegasystems, a customer service platform provider.

Opposite, Thinkstock; Above, courtesy Pegasystems

Cyber Insurance: The Keys to a Good Deal

CFOs and risk managers need to have a firm grasp of the processes insurers use to underwrite corporate cyber-security risks. **By Lynda Bennett**

The cyber insurance market continues to evolve, and the number of companies buying cyber insurance continues to expand. What's more, the expanding cyber market offers a wide variety of coverage terms at different price points. ¶ But companies interested in securing cyber insurance should know that the underwriting process requires careful diligence on their part. CFOs and risk managers need to have a firm grasp of the processes insurers use—not only to price a policy but also to determine whether they will agree to underwrite the risk at all.

One of the first steps in the underwriting process requires the company to submit an application to the insurer. The application will seek baseline information about the company's size, number of records maintained, type of information maintained, security policies and procedures, and disaster planning.

The company's ability to answer those questions with complete and detailed information is critical. Comprehensive answers can help ensure that the policy will be competitively bid by a number of insurers and secure the lowest premium pricing.

Underwriters will be most interested in companies that can communicate effectively that they know where their records are maintained and how many records are at risk. They're also more open to companies that have implemented strong security measures to protect their records and minimize the likelihood of a breach.

Further, cyber carriers will also look for the company to make representations in the application about whether it—and sometimes what's termed "any insured" (which means all employees)—has knowledge of claims, facts, or circumstances that could spawn a claim.

Some companies err by providing a response to that question without giving enough consideration as to who within the organization is being asked to make that representation or on whose behalf the representation will be made. The consequence of failing to understand the importance of these requested representations can be severe.

For example, let's look at the experience of a hypothetical credit card company that has just disclosed a hacking incident that compromised many customer email accounts several years ago. In its current disclosure, the company admitted that some of its employees, including senior executives and attorneys, knew about the breach at the time of the incident.

Even though the company had applied for and bought a cyber insurance policy late last year, coverage in this scenario could be seriously at risk. That's because employees' previous knowledge of the incident could lead to an objection by the insurer that the company didn't disclose that knowledge for several years.

Further, basing their claim on these facts, some insurers could seek to rescind the entire policy, asserting that a material misrepresentation was made in the application. In other words, insurers could argue that they have no coverage obligation for the undisclosed known breach or any other claims that may arise because the policy was issued under false pretenses.

'Meet and Greet' Underwriting

Once the application has been submitted, the underwriters may want direct access to the chief information officer or others responsible for protecting company information. Companies must understand that those individuals will play a key role in whether the insurer will agree to quote or how much will be charged to insure the risks.

But most CIOs and other "techies" aren't familiar with the insurance procurement process and may not understand how information should be communicated to the insurer. To avoid missteps, companies should have a detailed planning meeting with representatives of the insurer along with the insurance broker and coverage counsel before information is relayed to the underwriter.

Finally, many insurers conduct their own diligence to evaluate whether to underwrite a risk and, if so, at what premium price point. Risk managers and CFOs should be aware that insurers are using a new type of metric to assess their companies' cyber-risk exposures. It's called a "security score"—a concept akin to a credit score.

For example, BitSight Technologies is a risk assessment vendor that analyzes companies for breach risk and response preparedness and assigns a security rating. According to its website, BitSight gathers data on security breaches from sensors deployed across the globe and uses algorithms to assess a company's records management, encryption methods, and security vulnerabilities.

The firm then assigns a security rating and provides benchmarking information to demonstrate where the company falls short on the risk assessment spectrum. Companies on the lower end of the spectrum may not receive a quote for cyber insurance, while companies on the higher end may receive better terms in the form of lower premiums or lower retentions. Companies looking to buy cyber coverage need to know that, in an important sense, they are not alone. CFO

Lynda Bennett is the chair of Lowenstein Sandler LLP's insurance recovery practice.

Risk Management Costs Dive 5%

One of the main drivers in 2016 was a drop of 12% in the cost of covering property risks.

With the insurance industry glutted with capital, corporations are among those benefiting from the oversupply. They paid lower prices for property-casualty coverage in 2016, according to the Risk and Insurance Management Society's annual benchmark study.

The main drivers of a 5% overall decline in risk-related expenses were a 12% drop in the cost of covering property exposures; a 6% decrease in the cost of covering workers' compensation; and a 5% fall in the cost of covering for liability, according to the study. The only area in which risk managers saw rising costs was in the cost to cover fidelity, surety, and crime losses.

Regarding projections for property-casualty insurance markets for 2017, the authors of the RIMS study defer to Well's Fargo's January Insurance Market Outlook, which predicts more moderate declines in insurance premiums. For instance, prices in property, primary general liability, and workers' compensation lines should range from flat to 10% decreases this year, according to Wells Fargo.

Last year, however, corporations and other types of organizations enjoyed sharp reductions in the cost of covering their risk exposures. After falling 2%, to $10.55 per $1,000 of revenue in 2015, the total cost of risk (TCOR) reached a three-year nadir of $10.07 in 2016, according to the survey. (TCOR is calculated by adding three corporate costs—insurance, retained losses, and risk management department overhead—and dividing by 1,000.)

Perhaps paradoxically, the authors of the RIMS survey note that a key driver of the declines in insurance premiums in 2016 was the financial health of the property-casualty insurance industry. Noting that the industry ended 2016 with its average capital and surplus at a 10-year high, they suggest that all those dollars represent an oversupply. And like most oversupplies, the commercial insurance industry glut has pushed prices down.

All that excess capacity to underwrite risk "is expected to continue exerting downward pressure on rates," according to the survey. That pressure will persist as long as "insurers compete with new and existing players for market share in an overcapitalized environment and a slowly growing economy."

With insurance so cheap, CFOs appear to have inferred that their organizations are less in need of risk managers to haggle over prices. Organizations slashed their total risk management department costs by 11% in 2014, 13% in 2015, and 7% last year, according to the survey, which found that the average size of a risk management staff was six.

The comparative annual percentages in the RIMS survey, which is produced with risk management data provider Advisen, are derived from a database of more than 20,000 insurance policies from 759 organizations, according to RIMS. For the 2016 findings, 553 of those organizations contributed data. **DAVID M. KATZ**

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How to Tell Good Buybacks from Bad

A Buyback ROI tool helps determine when buybacks are more likely to be successful.

By Gegory V. Milano and Joseph Theriault

Almost six years ago, we introduced Buyback ROI on CFO.com in an article titled, "What's Your Return on Buybacks?" Buyback ROI is defined as a company's annualized rate of return based on the cash spent on buybacks, the money saved by "avoiding dividends" on the repurchased shares, and the change in the stock price since the buyback. Since that initial article, Buyback ROI has been used by companies and investors to compare the return realized on buybacks to the returns earned on other uses of capital, such as acquisitions and capital expenditures. It has become a useful tool in evaluating capital deployment effectiveness.

However, we find that companies often struggle with translating the metric's usefulness in evaluating the past into a forward-looking application. Buyback evaluation (or the lack thereof) is often disconnected from the rigorous analysis typically associated with other forms of capital deployment. This disconnect likely reflects the common adoption of the "pecking order theory" that encourages a residual distribution policy. There are likely a few other motivations as well.

What's the alternative? Until now, the best one could do was to suggest executing buybacks in advance of share price increases. A higher future share price will help drive a higher ROI. But who doesn't think their stock is cheap? Most managers believe their stock is undervalued and will rise in the future, so what is needed is a more rules-based process for evaluating buyback timing in order to deliver a desirable Buyback ROI.

We suggest that managers first perform a sanity check: (1) solve for the future earnings and multiple expansion scenario(s) necessary to deliver various levels of share price performance and subsequent Buyback ROI and (2) compare this performance to the past to get a sense of how likely it is that the company will achieve strong Buyback ROI.

To illustrate this exercise, consider IBM. If you assume the company maintains its current dividend yield of 3.8%, its share price would need to grow by 11.2% per year to achieve a 15% Buyback ROI (15%-3.8%, Buyback ROI incorporates the benefits of forgone dividends). This suggests a share price of $270 five years from now. IBM's share price on May 18 was $150.96.

The consensus of the brokerage analysts that follow IBM is that it will deliver $13.60 of earnings per share over the next twelve months and 4% EPS growth over the long term. Compounding this growth rate until year five suggests a future EPS of about $15.88. The implied price-to-earnings multiple in year five would be the share price of $270 divided by the EPS of $15.88, or 17.0x.

For IBM, a 17.0x multiple is higher than 96% percent of the historical observations of its stock price over the last decade. The past is not always a good indicator of the future, but if IBM's future valuations are at all like the past, this would suggest that buybacks are unlikely to deliver a 15% Buyback ROI at IBM.

There are other companies where there appears to be a better likelihood of achieving a strong future Buyback ROI. One such company is Southwest Airlines, which exhibits a relatively low current PE multiple versus the

“Most managers believe their stock is undervalued and will rise in the future, so what is needed is a more rules-based process for evaluating buyback timing in order to deliver a desirable Buyback ROI.”

—Gregory V. Milano, Fortuna Advisors

company’s past, and a relatively strong consensus long-term EPS growth rate. To achieve a Buyback ROI of 15%, the implied year-five PE multiple is only at the 28th percentile against the stock’s past. It seems much more likely that Southwest can achieve a 15% Buyback ROI than IBM can.

Additional facets of the analysis can be added. For example, the analysis can also be done in reverse. Using IBM’s historical median PE multiple would imply a 9.3% Buyback ROI instead of the 15% that we solved for. A similar analysis for Southwest implies a Buyback ROI of 19.9%—more than twice that of IBM.

Variations of this exercise can be used to formulate a rules-based buyback framework that relies on a combination of important factors (company price multiples, earnings growth, probability of future multiple expansion, future cash needs and alternative uses, and market valuations and trends). Such a framework will help increase the likelihood of a high buyback ROI by (1) providing a return-based focus for buybacks and (2) helping to improve timing.

These days, many executives say that investors put tremendous pressure on companies to buy back stock at all points in the market cycle. The approach described above can be used by managers to formulate and explain their capital deployment strategy. But it goes both ways. It can also be used by investors to apply more pressure when the timing seems advantageous and less when it doesn’t. CFO

Gregory V. Milano is founder and chief executive officer of strategic advisory firm Fortuna Advisors LLC; Joseph Theriault is a vice president.

Banks Tighten CRE Lending

The tighter standards reflect, in part, a less favorable outlook for commercial real estate prices.

Banks tightened lending standards for commercial real estate loans in the first quarter, reflecting a more uncertain outlook for CRE property prices, according to the Federal Reserve.

The Fed’s April survey of senior loan officers found a net 32.4% said they tightened standards somewhat on construction and land development loans, while 36.1% said they tightened somewhat or considerably on multifamily loans. On net, 12.5% said they tightened standards for loans secured by nonfarm nonresidential properties.

It was the sixth consecutive quarter to show a tightening of CRE lending standards.

Banks that tightened their credit policies cited the less favorable or more uncertain outlook for CRE property prices, vacancy rates, and capitalization rates, as well as their reduced tolerance for risk.

“Significant net shares of banks also reported less aggressive competition from other banks or nonbank financial institutions, and increased concerns about the effects of regulatory changes or supervisory actions, as important reasons for tightening CRE credit policies,” the Fed said.

For consumer lending, banks reported tightening standards on and weaker demand for auto loans and easing standards on and weaker demand for credit-card loans. On balance, banks tightened most terms on auto loans, with a moderate net fraction widening the spread of loan rates over their cost of funds and reducing the extent to which loans are granted to some customers that do not meet credit-scoring thresholds.

Commercial and industrial lending was mostly unchanged, though a few firms reported slightly easing their standards for large- and middle-market firms (2.8%) and for small firms with less than $50 million in revenue (2.9%). Banks that reported easing cited more-aggressive competition from other banks or nonbanks and a more favorable economic outlook.

On the residential lending side, banks reported that both loan demand and loan standards remained mostly unchanged, though a net 11.3% eased standards somewhat or significantly for government sponsored enterprise-eligible mortgages. ▸ **MATTHEW HELLER**

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How Millennials Can Find Work with a Purpose

Today's early-career finance employees want to do work that has significant impact from day one. By Neil Williams

Early-career employees energize any organization. They help drive innovation and speed of progress through fresh perspectives and a hunger to learn. They're technology-forward and driven to quickly forge their mark in the workplace. ¶ They are, of course, well known as millennials—with their own career expectations and way of looking at life. Last year, they became the largest generation in the American workforce. As they begin to dominate the workplace, deeply understanding their expectations and making proactive changes based on them can contribute to an organization's ability to attract and retain top talent at any level.

Today's early-career employees want to do work that has significant impact from day one. They seek rapid learning and rapid career development. Is it realistic or fair for someone to expect to do meaningful work from his or her first day? It's a legitimate question, especially in traditional finance roles where someone with an MBA might work on spreadsheets for the first six months.

Once you get past initial differences in style—their willingness to speak up in a way that others may not, for instance, and their life-stage tendencies to blend work and personal time—those early in their career are looking for things every employee wants: a chance to do work with purpose and the freedom to achieve and quickly prove themselves.

Whether in finance or across your organization, it's critical that your workforce mirrors your current customer base and the customer base you want to have down the road. Now that millennials are the country's largest living generation, if they aren't well represented, you should worry about whether you're building the right products and services.

There's a perception that millennials may view jobs in finance as being less exciting than those with direct impact on customers, like product or marketing roles. But companies simply must work harder to explain the role that a finance professional plays and why it, too, is work with a purpose.

At Intuit, we believe the onus is on us to reframe what we're asking people to do and why we're asking them to do it, so they can see it in a different light. Success in finance is measured by the insights you can bring that have influence across the organization. Finance can drive change.

Cross-training is one way we've mixed things up. Some people on our finance team have undergraduate engineering degrees. They can speak the language of the business partner they're working with, delivering the financial perspective in the language that a computer scientist or electrical engineer can understand. It can really help finance navigate across the organization.

Customer engagement is another big motivator. We created a customer retention team after finance team members called customers to understand their reasons for letting subscriptions lapse. We're now saving $175 million a year in subscription revenue because of the new initiative.

We also have 25 small finance teams that have volunteered to work with small business owners who are using our QuickBooks product. For a millennial who wants to have real impact and purpose, spending time with customers and learning how their business works and what their challenges are is incredibly motivational.

Following are some tips for making sure an organization is top of mind for young professionals:

• **Open the aperture in finance hiring.** Be willing to look for people with more diverse backgrounds and skill sets, and help them understand how a role in finance can be important and meaningful. Be cautious about unconscious bias around age and work experience.

• **Remember that motivation is universal.** Look at the similarities between the millennial workforce and the older employee population, as opposed to accentuating the differences. Flexible schedules and on-site amenities like a workout room or snacks make the environment more welcoming for everyone.

• **Reexamine rewards programs.** Millennials want more frequent rewards. The annual incentive bonus is important but can be enhanced by something more motivational and immediate along the way. It can be a lunch or a pizza night. The point is to closely associate it with the event that happened to earn the recognition.

• **Embrace more frequent feedback.** Early-career talent value more-frequent conversations about how they're doing. If you're still tied to an annual evaluation cycle, consider adding a more frequent check-in. At Intuit, this has evolved into a monthly discussion. Is there a high performer on the staff who wants to touch base twice a month? Make time for it.

• **Be less of a boss and more of a mentor.** More engaging interaction with a boss or supervisor includes coaching moments outside of formal feedback. I've seen millennials walk into a manager's office if the door is open. Nobody gets tossed out because they walked in unannounced; the interaction is too valuable.

Neil Williams

"Companies simply must work harder to explain the role that a finance professional plays and why it, too, is work with a purpose."
—Neil Williams

Younger employees want to be measured on what they've accomplished, not how many hours they've put in. If your organization can be more flexible about how (and where) work gets done, employees can maintain a better work-life balance, and that reinvigorates passion in the workplace. CFO

Neil Williams is Intuit's executive vice president and chief financial officer.

CFO Base Pay Rose 2.8% in 2016

Controllers and management-level finance team members got higher raises.

Finance professionals, except for CFOs, earned higher base pay raises than the average U.S. worker in 2016. Finance team members received an average increase of 3.5% in base pay in 2016, slightly less than their increase in 2015, according to data from the Association for Financial Professionals. But that was still higher than the average U.S. increase for all workers, widely reported to be about 3%.

Management-level finance staffers enjoyed the largest average salary raises in finance—4%, according to the AFP. Staff-level professionals earned average pay increases of 3.4%.

Finance chiefs saw their base pay increase 2.8% last year, but they were outpaced in the executive tier by controllers, who garnered the highest average base salary increase of 3.3%. Within the management tier, both managers of treasury/finance and financial reporting specialists saw an average salary hike of 5.1%—the largest increase for all 20 titles tracked. Accountant I and Accountant II positions both earned the highest increase at the staff level (3.9%).

These numbers come from AFP's 2017 annual compensation survey, which gathered data from 3,100 U.S. finance professionals in February 2017.

According to the survey, CFOs earned an average base salary of $211,439 in 2016, with an average 2016 bonus of $89,618. Treasurers earned an average of $192,584, with an average bonus of $78,043, and controllers earned $126,869 on average, with a bonus of $26,945.

As might be expected, executive-tier finance professionals, which include CFOs, treasurers, vice presidents of finance, and controllers, received the largest average bonuses as a percentage of base salary—36%. The average bonus for management-tier professionals was $20,804, equivalent to 19% of base salary. Staff-tier bonuses averaged $5,048, or 8% of base salary.

Of those organizations that gave bonuses to their finance professionals in 2016, 94% awarded cash bonuses and 31% awarded stock options.

The most common measures determining performance bonuses were operating income or EBITDA targets (chosen by 64% of respondents), completion of specific projects (49%), profit or increased profit targets (48%), and sales or increased revenue targets (32%). **VINCENT RYAN**

Thinkstock (2), courtesy Intuit

Green Reporting Takes Root

As more investors link sustainability with financial returns, they press issuers for meaningful environmental and social disclosures.

By David M. Katz

In its most recent 10-K filing, Host Hotels & Resorts included two charts showing energy and water use at its properties over the prior three years. Each chart showed steep descents in the company's consumption of those resources. The disclosure, and the circumstances leading up to it, were unusual in at least two respects.

One was that the company, a publicly traded real estate investment trust (REIT), reported those numbers in its financials at all. Indeed, in the fiscal-year 2015 annual reports of the 10 companies with the largest revenue in each of 79 industries, only 19% of about 4,000 possible sustainability disclosure entries were reported as metrics, according to the Sustainability Accounting Standards Board.

In contrast, the most common form of sustainability disclosure was generic boilerplate language, which was used in 43% of all disclosure entries analyzed by SASB. The organization, which sets voluntary corporate sustainability disclosure standards for those 79 industries, tends to frown on boilerplate, defining the word as "generic statements that are not specifically tailored to the individual company and the risks it faces" and branding its use as "inadequate for investment decision-making."

To SASB, the specificity of Host Hotel's charts in its 2017 Management Discussion and Analysis (MD&A) was a shining example of investor-friendly sustainability reporting. Most often, the impetus for reporting such environmental, social, and governance (ESG) factors in 10-Ks stems from someone with a title like that of Michael Chang, Host's director of energy and sustainability.

But here again, the REIT, which owns 96 mainly luxury and "upper-upscale" U.S. hotels containing about 53,500 rooms, is an anomaly. While Chang's sustainability group worked on the disclosure, it was the company's finance team members who "were the main drivers ... to get this information into a 10-K" for the first time, he says.

Getty Images

Green Reporting Takes Root

With Host's CFO Gregory Larson getting buy-in from the rest of senior management, the effort to fit the water and energy data into a financial reporting context was led by Brian McNamara, the company's controller. McNamara's team led the move "because they control the 10-K and everything that goes in it," Chang said.

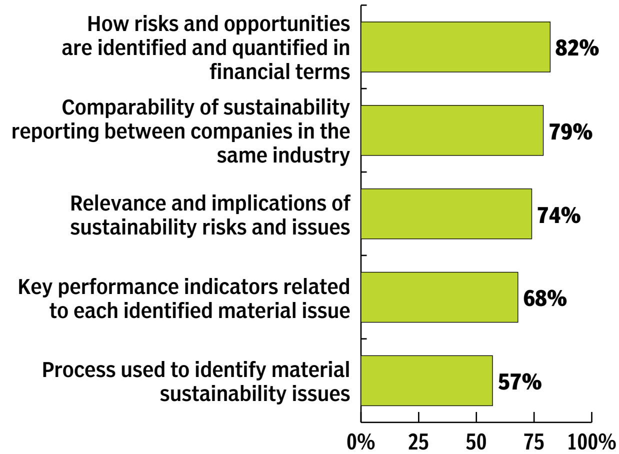
At many other companies, however, senior finance executives have long interpreted their responsibility for control of financial report contents as meaning that they should report as little sustainability information as possible. Until recently, large institutional investors, pension funds, and money managers showed a parallel lack of interest, reasoning that the link between ESG factors and future cash-flows was vague at best.

But now it appears investors have grown more hungry for sustainability metrics. In their view, the gender breakdowns of boards, the possibility of droughts, or the likelihood of regulatory crackdowns have suddenly become the stuff of material disclosures. And, perhaps more significantly for investors, they may be the secret to outsized rates of return.

Pain Points

Investors have a high degree of dissatisfaction with the current state of environmental, social, and governance disclosures.

% of investors saying they are dissatisfied



Source: "Sustainability Goes Mainstream," PwC, May 2014

A Proxy for Alpha?

Investor demand for sustainability data has been surging. In its 2016 report on sustainable investing, US SIF, the association formerly known as the Social Investment Forum, reported that investors consider ESG factors across $8.72 trillion of professionally managed assets—a 33% rise since 2014.

"Companies need to understand that they need to satisfy the demand. But there's a disconnect between what investors are [demanding] and what companies are reporting," says former SEC chair and current SASB director Mary Schapiro.

Part of the disconnect may come from finance executives' failure to grasp that investors' newfound lust for ESG information may be fueled by a desire for better returns in a low-interest-rate environment. For their part, many money managers are indeed starting to see sustainability data as a proxy for alpha, an indication of above-average returns.

Will Ortel, a researcher at the CFA institute, for instance, blogged his belief last year "that the investment profession sees at least the seed of alpha generation within ESG disclosures." He saw evidence of that in the 7% of 535 respondents to a CFA poll who answered "Of course" when asked, "Do you think analyzing ESG factors can boost returns?" Further, 37% answered "Somewhat—these factors enter into any complete analysis."

Despite the existence of studies suggesting links between sustainability reporting and higher returns, however, skeptics on both the corporate and asset management sides still abound. For example, 15% of the respondents to the CFA poll answered, "No way—they're called nonfinancial for a reason."

"There's a disconnect between what investors are [demanding] and what companies are reporting."

—Mary Schapiro, former SEC Chair

Powerful Advocates

There are, however, powerful advocates for the incorporation of sustainability and other nonfinancial factors into fundamental financial analysis and valuation. "With intangible assets accounting for more than 80% of the market value of S&P 500 companies, and stocks trading at multiples of book value, analysts require better information on 'nonfinancial factors' to understand what the market is paying for," UBS Asset Management contends in a case study that appeared in ESG Integration Insight, a SASB publication, in 2015.

The asset manager offers examples of nonfinancial ESG factors "that have changed the value-creation prospects of public companies, but for which fundamental equity analysis does not readily account." The examples include droughts like the one in Kerala, India, that marred the reputations of

U.S. beverage makers, and labor practice risks like the 2013 collapse of the Rana Plaza clothing factory in Bangladesh.

"Increasingly, many asset managers and a growing number of investors view ESG factors as complementary to fundamental analysis. Examining corporate performance on material ESG factors ties into financial theory to complete the picture on valuation," according to the UBS case study.

To Goldman Sachs, the picture appears close to completion. In an April equity research report, the investment bank claims to have found direct links between corporate environmental and social factors and company financial performance. "Our analysis shows that by focusing on a selective suite of key ESG metrics, mainstream investors can add a differentiated and alpha-additive complement of risk analysis to their toolkit," according to the report. "Where robust data is available, [environmental and social] metrics make a tangible difference to performance."

The authors of the report go on to advise portfolio managers to use sustainability data as a risk management tool that could help them identify and avoid companies with lagging ESG performance. For instance, since 2011, companies that fell in the bottom quartile of sustainability performance have underperformed sector peers by 135 basis points per year on average, according to Goldman.

The investment bank lists employee and board diversity, resource conservation, and low employee turnover as indicators of superior company financial performance. Companies employing more women, for instance, "have seen average annual alpha of 3.3%," according to the report. Using less energy and water per unit of space generated 2.6% (energy) and 1.8% (water) in alpha annually. And companies with low employee turnover spurred 0.8% annual alpha on a three-year test and 3.0% in a 5-year test.

Passively Active

If equity research proceeds in the direction of requiring more ESG disclosures, pressure on CFOs to dig deep into their companies' data to find and report potential sources of sustainability excellence is sure to mount. Even passively invested institutional investors like CalSTRS, the California teachers' retirement fund, are finding ways to turn up the heat on the companies they invest in.

Since CalSTRS invests largely in index funds, it can't exert market pressure by selling the stock of companies that are known polluters or that don't report sustainability metrics. Instead, the pension fund's managers take a more direct approach, meeting with sustainability executives at companies whose behavior they want to change.

"We look at our portfolio and say: 'Which companies aren't paying attention to [a] particular issue, whether it's carbon emissions, energy use, methane emissions?" says Brian Rice, a CalSTRS sustainability portfolio manager. "Then we reach out to them and try to have a conversation about the risk and the value proposition."

In a recent case, the fund pressed companies to disclose more about their performance in curbing methane emissions. Its ultimate position was that, instead of letting the chemical into the atmosphere, polluters should try to cap-

What Companies Disclose

Boilerplate is still the most common kind of sustainability disclosure offered by companies that report to the SEC.*

Sector	No disclosure	Boilerplate	Company-tailored narrative	Metrics
Infrastructure (utilities, construction, real estate)	16%	42%	20%	22%
Alternative energy (biofuels, solar, wind, pulp & paper products)	15%	53%	13%	19%
Consumer goods & retail	26%	48%	17%	8%
Food & beverage	19%	52%	19%	9%
Resource transformation (chemicals, aerospace & defense, industrial machinery)	18%	46%	17%	19%
Services (professional, lodging, restaurants, media)	17%	46%	20%	17%
Transportation	14%	31%	29%	26%
Nonrenewable resources (oil & gas, coal, metals & mining)	16%	38%	19%	27%
Technology & communications	25%	54%	12%	9%
Financials	27%	24%	15%	34%
Health care	19%	43%	21%	17%
All Sectors	**19%**	**43%**	**19%**	**19%**

*Sustainability disclosures in 10-Ks for fiscal year 2015, by sector. SEC filings analyzed were from the 10 companies with the largest revenue in each of 79 industries.
Numbers may not add to 100%, due to rounding.

Source: Sustainability Accounting Standards Board

ture it and profit from its safe use. In a number of instances, CalSTRS officials told companies they needed to report the percentage of company infrastructure that was checked for leaks, how often it was checked, and the kind of technology that was used, according to Rice.

After the pension's representatives present what they consider to be a good case based on the value to the company of adopting a given ESG measure, company executives might protest, contending that they don't think it's "in the best interest of the broad shareholder base [or that] the broader shareholder base doesn't care," he says. "So we say, 'We want to file a proposal about the issue. Let's take it to the shareholders for a vote and see what they say,'" Rice adds.

While he tends to have these discussions with company sustainability executives rather than with their finance chiefs, Rice thinks that the issues the talks raise are inevitably matters of corporate finance. "Certainly it all comes down to the valuation of the company," says Rice. "We pursue these issues because we think that paying more attention to ESG, climate-change risk, water use, pollution, and worker health and safety all translate to the bottom line."

The Resistance

Many companies have only just started to buy into the notion that their financial reporting should incorporate ESG factors. Even more, perhaps, still resist the idea of reporting any ESG information at all. Corporate finance attitudes like

"Rather than reporting [ESG] factors in a standalone section, we recommend identifying and reporting them as risk factors."

—Frederick Crawford, CFO, Aflac

those expressed by General Motors and Aflac in response to a concept release published last year by the SEC are much more typical than those of Host Hotels.

In the release, the commission floated the idea of requiring companies to make line-item sustainability disclosures in their 10-Ks: "Would line-item requirements for disclosure about sustainability or public policy issues cause registrants to disclose information that is not material to investors?"

Firing back in a September 30, 2016, comment letter to the SEC, Thomas Timko, GM's controller and chief accounting officer, argued that mandating sustainability disclosures would amount to "overburdening what is principally a financial and operational report with information that is immaterial to financial or operational performance, or, more importantly, immaterial to an investor's investing or voting decisions."

For his part, Aflac CFO Frederick Crawford pleaded for the exclusion of his industry from any such rules. The hospital-care insurer's management doesn't believe that "companies such as those in the insurance industry should be required to disclose immaterial public policy and sustainability matters," he wrote.

Crawford also made the case that standard MD&A risk disclosures, instead of more-detailed revelations, would be enough. "Rather than reporting [ESG] factors in a standalone section, we recommend identifying and reporting them as risk factors," he added.

A Surplus of Standards

One reason finance chiefs may be uncertain about incorporating sustainability metrics in their companies' 10-Ks is that there are so many environmental, social, and governance reporting standard setters. Here are five of the most prominent.

Sustainability Accounting Standards Board (SASB)
Sets industry-specific standards for corporate sustainability disclosure that's "material, comparable, and decision-useful for investors."

Carbon Disclosure Project (CDP)
Runs a global disclosure system enabling companies to measure and manage their environmental effects. Claims to have amassed "the most comprehensive collection of self-reported environmental data in the world."

Global Reporting Initiative (GRI)
An "international independent standards organization that helps businesses, governments, and other organizations understand and communicate their impacts on issues such as climate change, human rights, and corruption."

Global Real Estate Sustainability Benchmark (GRESB)
An "investor-driven organization committed to assessing the ESG performance of real assets globally."

International Organization for Standardization (ISO)
Sets standards that "enable businesses to plan their future growth around meeting consumer expectations. They enable transparency about products and best practices for limiting their impacts."

Source: organizations' websites

But finance teams could still choose to report only sustainability information that they deem material to their company's fortunes. That would certainly be the case if SASB's standards come into widespread use. "SASB standards address the sustainability topics that are reasonably likely to be material and to have material impacts on the financial condition or operating performance of companies in an industry," according to the nonprofit organization's website. The standards "are designed to be integrated into the MD&A and other relevant sections of mandatory SEC filings such as the Form 10-K and 20-F [the annual report for foreign private issuers]," the board says.

Further, SASB often avows that, unlike the Financial Accounting Standards Board, its strictures are voluntary and market-based—leaving senior finance executives very much in the driver's seat about what ESG factors are essential for investors to know about.

A Fragmented World

Because sustainability disclosures are voluntary and market-based, though, there's no single disclosure standard that companies can follow. One reason for CFOs' wariness of sustainability reporting may be an uncertainty spawned by the current blizzard of ESG reporting frameworks (see "A Surplus of Standards," page 32).

"We live in a very, very fragmented world of sustainability disclosure," says Sara Neff, senior vice president for sustainability at Kilroy Realty, a REIT.

As tough as it can be for corporate executives, it can also be difficult for investors to find the right scorecard to use in assessing sustainability. "In the investor community, everyone is really hungry for [a] standard disclosure so that they don't have to wade through a bunch of noise," Neff adds.

Some experts claim the SEC could be doing more in this area. The requirements for material disclosure in financial statements, including rules mandating reporting of material information regarding climate change, "already exist, and through the comment process, the SEC could be encouraging more complete disclosure," says SASB's Schapiro.

The current commissioners could focus on climate change by moving forcefully to comment on the adequacy of environmental disclosures in 10-Ks "without the SEC having to write any new requirements, interpretations, or guidances," Schapiro adds.

In the meantime, companies that are motivated to disclose sustainability data to investors will have to maneuver through some uncharted waters.

Like Host Hotels, Kilroy Realty disclosed water and energy metrics for the first time in its 2017 annual report. (Both companies followed SASB guidelines for the REIT industry.) In deciding which years of sustainability data to report in its most recent 10-K, though, Kilroy executives faced a dilemma in bringing ESG data into its financial statements. Beginning with 2013, the company had been making full years of energy and water data available to the public. Although a third party had verified the data, it hadn't been audited for SEC reporting purposes.

In the run-up to closing the 10-K, the problem was that Kilroy's full calendar-year environmental data had yet to be verified and wouldn't be available until March 30, 2017. The company's finance and sustainability teams agonized over which data set to employ. "Do you use 10 months of correct data and then start estimating?" Neff says. The other alternative was to use the less timely, but fully verified, 2015 data to complete the reporting of a three-year trend.

"We live in a very, very fragmented world of sustainability disclosure."

—Sara Neff, senior vice president for sustainability, Kilroy Realty

Kilroy took the latter route, deciding to disclose "tightly, rigorously reported data rather than risk some estimating," Neff explains. But the decision was a difficult one because the company felt it had timely data to support a sustainability story that it was eager to tell to its largely youthful and environmentally committed tenants.

Neff feels that the potential difficulties in getting ESG data in time for the closing of the annual report might put off some CFOs. "The timing of this stuff is really tricky," she notes. On the other hand, CFOs in industries with a less positive ESG narrative might be fearful of reporting too much of it to investors. "If you are in an industry that is an extreme polluter, there may be some questions about how you present the data," says Host Hotels' Michael Chang.

Even executives at Host, which is eager to tout its ESG-friendly investments, hesitated about reporting the results of the company's efforts in its annual report. "There was definitely concern that we were putting new information out there, and that new information brings more scrutiny," says Chang. "We've been reporting for several years [outside the financials], and it's taken that time for our executives … to buy into these metrics and get a level of comfort with them to report them out."

Are the struggles and risks of disclosing sustainability information worth it? The market is beginning to answer that question for CFOs, and the answer is in the affirmative. As one high-level Goldman Sachs executive put it, "As a company, if you ignore sustainability, you're going to be worth less." CFO

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

(2) Courtesy the companies

Team Trump's Tug-of-War

How will the president's economic advisers alter the global business prospects of U.S. companies? **BY RUSS BANHAM**

No man is an island, not even the leader of the free world. Since taking office, President Trump has been reshaping his campaign pledges. Prodding him to wield the chisel are his advisers: an unusual assortment of liberal-leaning family members, hardened Wall Street veterans, starched-shirt military commanders, and right-wing political strategists.

Out of that eclectic mix has come moderation. The president's recalibrated position on China's currency manipulation, his reversal on eliminating the Export-Import Bank, his comments that NATO is actually *not* obsolete, and his decision to renegotiate the North American Free Trade Agreement—days after saying he would sign an executive order to withdraw from NAFTA—indicate a willingness to listen to others' more seasoned views. Trump might →

Thinkstock

Team Trump's Tug-of-War

continue to temper his positions, albeit with a mindfulness toward maintaining his populist constituency.

For CFOs interpreting these changes, the shifting landscape in Washington is, for the most part, encouraging. Still, the president's sharp turns right and left are also perplexing, making it tough to call his next moves. To get a clearer sense of the administration's developing economic agenda, we reached out to five economists to posit their views on seven of the president's top economic advisers. These seven are pulling the strings—but they're not all pulling in the same direction.

"I think it's obvious that there is not a detailed blueprint of what the Trump agenda is," says Jeff Hauser, director of the Revolving Door Project, an initiative of the Center for Economic and Policy Research that scrutinizes executive-branch appointments to ensure they serve the public interest. "The general themes from his campaign are likely to stay consistent, but the specifics could flip-flop. That's why his choice of economic advisers is instructive—they're the ones who have his ear."

Mnuchin

> "The number one problem with Dodd-Frank is [that] it's way too complicated, and it cuts back lending, so we want to strip back parts of Dodd-Frank that prevent banks from lending, and that will be the number one priority on the regulatory side."
>
> —Mnuchin on CNBC, November 29, 2016

Who are these people? What are their backgrounds? And how may their opinions affect global business prospects for U.S. companies? Our analysis follows.

Steven Mnuchin

SECRETARY OF THE TREASURY

→ A former Goldman Sachs executive, Mnuchin holds some views that differ from Trump's pronouncements on the campaign trail. For instance, he supports the Volcker Rule, a part of the Dodd-Frank Act that restricts banks from making speculative investments in hedge funds and private equity.

Dismantling Dodd-Frank was a centerpiece of Trump's platform, and in April he signed an executive order to roll back certain provisions of the post–financial-crisis legislation. What's interesting is that the Volcker Rule was not among them.

"There's a sense, with some truth behind it, that Mnuchin has awesome influence," says Hauser. "He's playing a longer-run game, knowing it's unlikely that any legislation to completely gut Dodd-Frank will pass."

Mnuchin and another Trump adviser with roots at Goldman Sachs, Gary Cohn (see his profile below), are perceived as moderates who can shepherd the president's tax reform plan through Congress, giving him his biggest win to date. The pair stood side by side to announce the plan in late April. Mnuchin called it the "biggest tax cut in history," a declaration subsequently faulted for bad math.

Still, the tax plan is a gift to business. The big question is how the country will pay for it without adding to the ballooning federal deficit. The plan omitted the border adjustment tax on imports proposed by House Speaker Paul Ryan, which was seen as a way to make up some of the revenue shortfall.

In any case, Mnuchin will certainly be at the center of all economic maneuverings by the Trump administration. "He played a pivotal role with respect to the corporate tax cut and the elimination of the border tax proposal," says Robert Hartwig, a finance professor at the University of North Carolina with a Ph.D. in economics. "The latter would have entangled fiscal policy with trade policy in ways we've not seen in recent U.S history. He seems to have the president's left ear, while Cohn has his right."

Gary Cohn

DIRECTOR, NATIONAL ECONOMIC COUNCIL

→ Cohn, a lifelong Democrat and former president at Goldman, is reportedly close to Trump's senior adviser Jared Kushner, who's also a Democrat. Many see Cohn as the *yin* to chief strategist Steve Bannon's *yang*, his softer stance on regulatory reforms, immigration, and health care balancing Bannon's more populist positions.

He has made some surprising remarks, including a reversal of his pledge to dismantle Dodd-Frank. He even raised the possibility of legislation to reinstate the Glass-Steagall Act's separation of investment and commercial banking activities, to the delight of Democratic Senator Elizabeth Warren. He's come out strongly for free trade and was an early critic of the Republicans' first health-care bill, which folded quickly.

Getty Images


Cohn

"We have a 35% corporate tax rate, the OECD average is about 23%. GDP weighted [the corporate rate is] about 26%. We can't be that much higher than the rest of the world. We have to get competitive."
—Cohn on CNBC, February 3, 2017

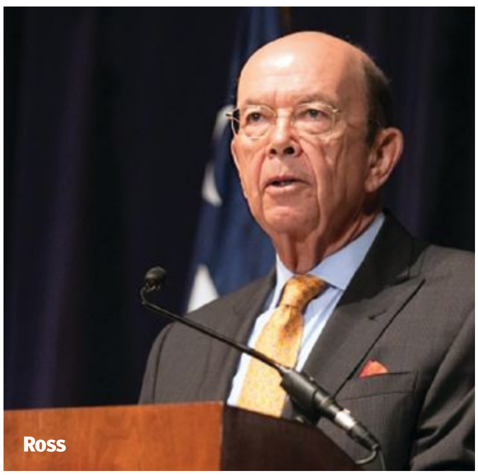
Cohn's star is said to be ascending, to the detriment of Bannon and trade adviser Peter Navarro. The president's reappraisal of his intention to toughen trade policy may be traced to Cohn's influence.

One expert thinks his growing prominence is good news for business. "Cohn understands that the thrashing between Wall Street and Main Street is not a case of polar opposites, as it's typically portrayed," says Mark Fratrik, senior vice president and chief economist at marketing research and consulting firm BIA/Kelsey. "When Wall Street is growing, it provides the financial foundation for people who have stocks and bonds to be more optimistic," says Fratrik. "This ties into their willingness to buy cars, fix up their homes, and go out to restaurants, creating capital for myriad businesses to invest in their [own] growth."

Wilbur Ross

SECRETARY OF COMMERCE

➔ An investor and former banker, Ross made billions of dollars in leveraged buyouts, making him the wealthiest member of Trump's well-heeled economic team. He's reportedly in charge of establishing the administration's trade priorities, a role usually assigned to the U.S. Trade Representative. Ross's initial task is to scrutinize existing trade agreements for evidence of violations and then to determine an appropriate response. He has said that will take time and patience—good news for free-trade advocates. Then again, Ross used some strong rhetoric in April when the Commerce Department announced duties of 3% to 24% on Canadian softwood exporters. He is also making noise about the necessity of defending the U.S. steel industry, tying the idea to national security concerns. "The whole idea of trade deals," Ross has said, "is to build a fence around participants inside and give them an advantage over the outside."


Ross

"I think we cannot afford trade that is inherently bad for American workers and American businesses ... I think tariffs play a role both as a negotiating tool and if necessary to punish offenders who don't play by the rules."
—Ross at his Senate confirmation hearing, January 18, 2017

Ross enjoys a long personal relationship with the president and is widely expected to be the most influential Commerce Secretary in modern U.S. history. While some of Trump's economic advisers are hardliners on trade, he is measured and pragmatic.

"Trump knows very little about the intricacies of trade deals, which he acknowledges are more complex than he had understood them to be," says Hauser. "He will lean on Ross, who is expected to have a lot of sway."

Peter Navarro

DIRECTOR, NATIONAL TRADE COUNCIL

➔ A former professor of economics at the University of California, Irvine, Navarro is a staunch nationalist on trade issues. He has regularly condemned the country's trade imbalances with China, Japan, and Mexico; suggested imposing a tariff on German automakers BMW and Mercedes-Benz; and raised the idea of making companies repatriate their global supply chains.

Laurence Kotlikoff, a professor of economics at Boston University who ran for president last year as a write-in candidate, is deeply alarmed by Navarro's views. "He's got a doctorate in economics, but given the things he's said I don't think Congress should view him as a real economist," he explains. "He apparently has no understanding of international trade or even rudimentary economics."

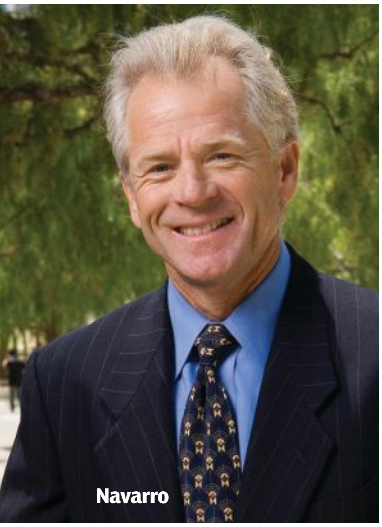
Asked to elaborate, Kotlikoff comments that the U.S.'s trade deficit is of its own making and that other countries are not to blame. "The real reason for the deficit is the difference between domestic investment and U.S. saving," he says. "Our country is saving just 4% of its output, far below the 15% national savings rate recorded in the 1950s. Instead, foreigners are

Cohn: flickr (World Economic Forum, swiss-image.ch/Remy Steinegger); Ross: U.S. Department of Commerce

Team Trump's Tug-of-War

investing here, which shows up in the form of larger trade deficits."

Other economists express similar concerns about Navarro. "He makes crazy comments that are disturbing, illogical, and inane," says Fratrik of BIA/Kelsey. "If the president followed what Navarro wanted, it would devalue what the [country's] founders did and wanted. Fortunately, I have enough faith in the ways of American government that I believe the dastardly things Dr. Navarro suggests won't come to fruition."


Navarro

"If the U.S. uses its leverage as the world's largest market to persuade India to reduce its notoriously high tariffs and Japan to lower its formidable nontariff barriers, America will surely sell more [U.S. products]."

—Navarro in an editorial in the *Wall Street Journal*, March 6, 2017

Echoes William Dickens, distinguished professor and chairman of the economics department at Northeastern University: "Navarro's clueless about supply-side economics, confuses tariffs with value-added tax, and doesn't understand that tariffs disadvantage imports."

Of course, none of that means Navarro won't wield any influence. "He has a world view he can connect to policy, which Trump could deploy if he seeks a trade war," notes Hauser.

Mick Mulvaney

DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

→ Mulvaney was on everyone's mind when the president's tax-cut plan was announced, given his reputation as a fiscal hawk. Would he approve of a giant tax cut without much of a plan to recoup the lost income?

His response: the tax plan's impact on economic growth, in addition to the closure of unspecified tax loopholes, would make up the difference. Or at least, that's what he hoped initially. He subsequently told CNBC that there's no way to know for sure what the effect on the deficit will be.

Clearly, Mulvaney is in a tough spot. The former Republican representative from South Carolina opposes hikes in defense spending that are not accompanied by non-defense spending decreases. That puts him at odds with the president's plans for vastly increased military spending.

Nonetheless, his fiscal hawkishness is seen as a needed balancer in an administration that's so zealous about "winning." Mulvaney was the principal architect of the failed 2011 Cut, Cap, and Balance Act to counter proposed increases in the debt ceiling. At the time, the federal debt was $14.3 trillion; today it's close to $20 trillion. Small wonder he's an uneasy defender of the "biggest tax cut in history."

He also parts company with the president when it comes to Medicare and Social Security, both of which Trump has vowed to keep intact. The budget director wants to increase the eligibility age for Social Security and supports means testing to qualify for Medicare benefits.


Mulvaney

"I'm not going to be able to pay off $20 trillion worth of debt in four years. ... The reason the president doesn't want to change some of the mandatory [government] spending is because the public's not ready for it yet."

— Mulvaney on CNBC, April 12, 2017

Robert Lighthizer

U.S. TRADE REPRESENTATIVE

→ Lighthizer was a deputy trade representative during the Reagan administration and helped broker bilateral trade agreements. A partner at law firm Skadden Arps, he is considered an expert in trade litigation, policy advice, and legislative initiatives. He espouses a hardline position on trade, particularly with regard to the interests of manufacturing, agricultural, financial services, and technology companies, the sectors he represents in his law practice.

Despite Trump's recent moderation on trade, Lighthizer is not likely to pull back from his position. "He represents the pre-existing flank in the Republican Party that has a rigid stance on trade, supporting a notion that

Navarro: courtesy *The Orange County Register*; Mulvaney: Wikipedia (Gage Skidmore)

Lighthizer

"Our objective is not just to get the trade deficit down, our objective is to get more efficiency in the market. ... Everybody wins, and the U.S. producers really win, to the extent we can break down trade barriers."

— Lighthizer at his Senate confirmation hearing, March 13, 2017

Navarro is not completely out of the game and Cohn's influence is not everything," Hauser says. "His trade experience will be taken seriously by all concerned."

After being confirmed in May, Lighthizer's first task was expected to be to negotiate with Mexico and Canada over NAFTA.

David Malpass

NOMINEE, UNDERSECRETARY OF INTERNATIONAL AFFAIRS, TREASURY DEPARTMENT

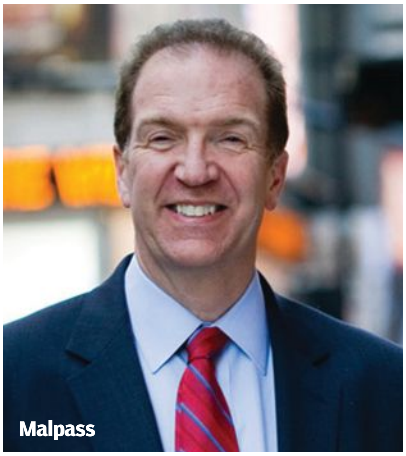
➔ The former Deputy Assistant Treasurer under two presidents (Ronald Reagan and George H.W. Bush) served on Trump's economic advisory team during the presidential campaign. He has been touted as a possible successor to Janet Yellen at the Federal Reserve, although Trump is now warming to the idea of retaining Yellen.

Malpass is controversial for having once called the housing and debt markets bit players in the U.S. economy. That was in August 2007, with the credit crisis having already begun, and scant weeks before the markets began hammering the economy at the beginning of the Great Recession. At the time Malpass was chief economist at Bear Stearns, which collapsed along with the housing market the next year and was sold to JPMorgan Chase for a pittance.

His tendency to make wrong calls—he also urged the Fed to sharply hike interest rates in 2011 to counter the threat of inflation—gives pause to many economists. "His forecasting record is abysmal," says Northeastern University's Dickens.

Malpass does bring extensive government experience. And his positions are clear. Chief among them: the Federal Reserve's interventionist policies are misguided; China and Japan have manipulated their currencies and thereby harmed U.S. economic interests; and U.S. tax policy must be overhauled.

Does he have the president's attention? Possibly yes, given the unveiled laundry list of proposed tax cuts; and possibly no, considering Trump's revised position that China is not in fact a currency manipulator.



Malpass

"The 10th amendment said the federal government is supposed to only have powers that were explicitly given in the Constitution. I think the federal government's gone way beyond that. The Constitution never said that you could have a Federal Reserve that would have $2.8 trillion in assets. We've gotten out of control."

— Malpass in a *Forbes* interview, June 13, 2011

➔ The Upshot

Stirred together in a pot with a pinch of Kushner and a dash of Bannon, the president's economic team is a strange stew. Hauser boils down the advisers into two groups vying for the president's attention—Malpass, Cohn, and Mnuchin versus Navarro, Mulvaney, and Lighthizer, with Ross in the role of swing voter.

On trade, the first group appears to have gained the upper hand. "The outlook for international trade is much better than it was on the days Trump was elected and inaugurated," says Hartwig. "We're beginning to see a move to the center in terms of the president's positions, pulled there by some of his key advisers."

Kotlikoff laments that the economic policy team "doesn't have one real economist on it." Fratrik, though, is buoyed by the migration toward more mainstream Republican positions, such as a tax cut coupled with more restrained and thoughtful trade actions. "I especially like the idea of having Wall Street people enmeshed on the economic team as a counterbalance to the trade protectionists," he says. "All in all, it should be good for business."

As the president's more experienced economic advisers gain footing, their influence may be tempering his hardline positions and having a tangible impact. "The truth is, he needed this kind of advice," says Hartwig. "It was pretty inevitable that this would happen." CFO

RUSS BANHAM IS THE AUTHOR OF 24 BOOKS AND A LONGTIME CONTRIBUTOR TO CFO.

Lighthizer: Getty Images; Malpass: courtesy Encima Global LLC

New Remedies

As core strategies for containing employee health-care costs diminish in effectiveness, companies need fresher approaches. BY DAVID McCANN

While the nation awaits the promised repeal and replacement of the Affordable Care Act, most employer health-plan sponsors have their attention focused elsewhere: health-care costs for employees at large companies are still rising an average of 4% a year, and at this point it's doubtful the 115th Congress will pass legislation that will curb medical cost inflation.

What's more worrisome to CFOs, though, is that some of the strategies companies have been using for years to keep a lid on health-care costs—such as shifting costs to employees, offering wellness programs, and adding consumer-directed health plans (CDHPs) to the benefits mix—may be nearing the end of their useful life.

Getty Images

Cost shifting is becoming less popular because employees may not be able to tolerate additional increases. In years past, a company could get away with raising co-pays by $15 or deductibles by $500, for example. "But if a company now has $1,500 individual and $3,000 family deductibles, it's hard to continue to increase employee costs," says Brian Marcotte, CEO of the National Business Group on Health (NBGH), an affiliation of approximately 425 large employers.

> **"Value-based care is an economic necessity if we're going to effect change in the health-care system and effectively manage costs."**
> — Brian Marcotte, CEO, National Business Group on Health

Wellness programs, meanwhile, have often not generated the returns employers were seeking. That's because—in spite of participation incentives—most of the employees who join such programs are already health-conscious and generate a tiny portion of medical costs.

"The likelihood that a wellness program will reduce medical costs over the next five years is very low," says Jeffrey Levin-Scherz, national co-leader of the health management practice at Willis Towers Watson. "People have been doing studies for decades, trying to legitimately prove that these programs lower costs, but they haven't been successful."

And what of consumer-directed health plans? The use of CDHPs, which carry high deductibles and thereby influence employees to consume less health care, has expanded dramatically in recent years. But, according to Marcotte, that growth means controlling costs by further tweaking health-plan designs is increasingly less viable. "The challenge for employers is, where do they go from here?"

The good news is that emerging options may offer more cost-control potential than any of the previous methods. Here's a look at some of the new things companies are trying.

HOLDING PROVIDERS ACCOUNTABLE

The most exciting development in controlling costs is in health-care delivery, where accountable care organizations (ACOs) are evolving into a significant force. ACOs are groups of medical providers that, instead of charging on a fee-for-service basis, agree to take on financial risk in exchange for a financial benefit if they hit certain cost and quality targets. Those targets revolve around particular patient populations for which ACOs provide coordinated care. This pay structure leaves ACOs with little incentive to pad the tab with unnecessary tests and procedures.

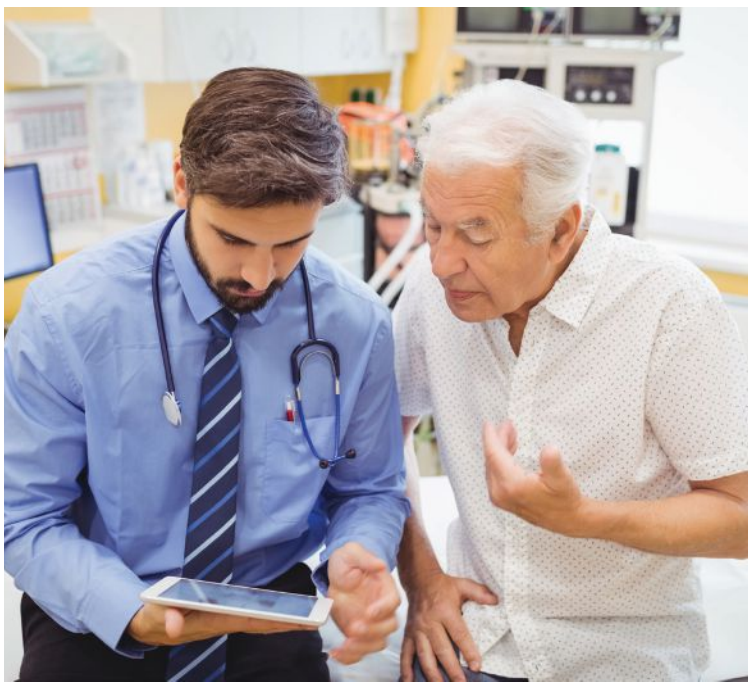
According to Health Care Blog, the number of ACOs in the United States grew from 64 in early 2011 to 838 in 2016. Meanwhile the number of contracts between ACOs and health-plan providers has increased from about 300 three years ago to more than 1,000 today, notes NBGH's Marcotte.

Still, the room for growth seems practically infinite. "About 25% of our member companies are involved in some type of value-based arrangement" such as those provided by ACOs, Marcotte says. "But those are more in specific geographic markets than broad-based. It's not like a company can flip a switch and start offering it everywhere, like companies did with managed care in the 1990s."

Managed care, which was based on coordinating all care through primary-care providers, was not the panacea for high costs that it was billed as. Employers don't want to make the same mistake with ACOs. "The reason we're not seeing a mass movement to ACOs is that employers don't know how to assess what's going to be different when using them," he notes. "And health plans haven't done a great job of explaining what that experience is going to be like."

One problem is that ACOs are in different stages of development and are of varying quality, and it's not easy for companies to distinguish those differences. Compounding that, ACOs are local organizations, so a large employer with a distributed workforce may have to use several ACOs to cover its employees.

To address this, NBGH conducted meetings with em-



Accountable care organizations agree to take on financial risk in exchange for hitting cost and quality targets for particular patient populations.

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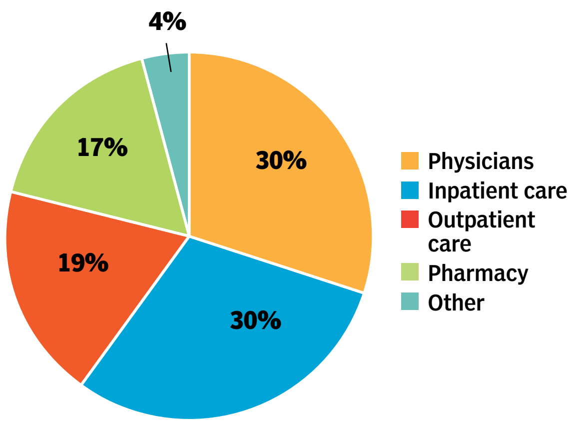
Where the Health Costs Lie

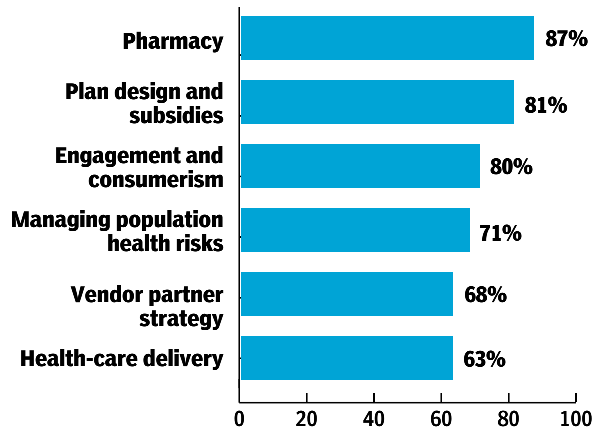
Roughly half of all medical costs are projected to come from hospital spending: 30% from inpatient and 19% from outpatient care.*



*Projections for 2017
Source: PricewaterhouseCoopers Health Research Institute

Top Cost-Management Priorities

Controlling rising pharmacy costs over the next two years is of greatest importance to organizations.*



*Percentage rating management of a given health-care cost at 4 or 5 on a 5-point scale (5=highest priority)
Source: Willis Towers Watson

ployers, health-plan providers, and medical providers to determine which ACO competencies are most important. The result was a "journey map" checklist that includes desired capabilities for ACOs of different maturity levels. NBGH also created a scoring guide to enable consistency when evaluating different ACOs. Altogether there are about 10 broad areas of competency, including the use of electronic medical records to track patients' history and needs, and 24/7 access to urgent care facilities.

NBGH plans to put the journey map and scoring guide in the public domain. "We want to help employers make these decisions," Marcotte says. "Value-based care is an economic necessity if we're going to effect change in the health-care system and effectively manage costs."

YOU'VE GOT A FRIEND

With good intentions, most companies offer an assortment of programs and services designed to help employees become and remain healthy. These may include weight-loss and smoking-cessation programs, second-opinion services, and mental-health counselors, among others.

"When there are several different programs, employees often don't know how to use them, [let alone] maximize their benefits," says Michael Thompson, CEO of the National Alliance of Healthcare Purchaser Coalitions, an umbrella organization for about 50 employer coalitions.

Additionally, people tend to engage with health care only when they need it. "If you suddenly have an issue, you talk to a medical professional, he tells you what to do, and you do it," says Eric Krieg, president of Risk International Benefit Advisors. Most of the time, people aren't stopping to think about whether they're taking the best route, what the implications of their actions are, or what other options might be available to them, he adds.

A surprisingly simple but effective antidote for those scenarios has been gaining in popularity over the past few years, though: creating what Thompson calls a "hub of support." The most successful of these have been "interpersonal hubs," in which an employee calls a single number for any health care–related issue. The first time an employee calls, even if it's for something simple like ordering a new insurance card, he or she is assigned to a specific health coordinator. That person will remain the employee's advocate for all future inquiries and can help him or her navigate through all the health options the company offers.

"These individuals build enough trust with employees that they get to know the issues in their lives," says Thompson. "The result is that engagement rates might be four times higher than what happens with typical consumerism strategies." The advocate also steers plan members to value-based providers and otherwise looks to hold costs in check for both employee and employer.

The service is often provided by a third party under a contract with a health insurer. The best-known third parties are Accolade and Quantum Health.

Among the employers that recently began offering such a hub is pharmacy chain Walgreens Boots Alliance. In this case, though, insurers are directly providing the servics for two of the three Walgreen health plans included in the program. The voluntary program, which launched on January 1, 2017, is available to about 110,000 U.S. members of three Walgreens health plans.

Among participants in the company's largest health plan, 55% of those who required care in the first quarter engaged with a health coordinator. "For a brand-new program, that's pretty great," says Thomas Sondergeld, Walgreens' vice president of global benefits. Is it possible to calculate the financial benefits of such a program? According to a 2016 actuarial opinion letter by Aon Consulting, in the first year of participation companies in one program experienced an average of 8.6% lower medical cost inflation than the market trend. Over time, the letter claimed, a company can cut medical cost inflation to between one-third and one-half of the market trend.

Some companies have conducted tests before committing to an interpersonal hub, making it available to half of the employee base while the other half continued with the traditional approach, according to Thompson. "What company after company found is that costs flattened out and in some cases dipped," he says.

GENETIC POLITICS

Genetic screening may be a tantalizing idea for saving on employee health-care costs. It can, for example, identify who's at risk for various types of cancer. Such employees can then undergo more intensive testing to search for cancer and catch it early.

Few employers have chosen to entertain the idea, though. Under two current laws, the Genetic Information Nondiscrimination Act and the Americans with Disabilities Act, employers can't even ask workers to undergo genetic testing, let alone require them to.

A Republican-sponsored bill introduced in March 2017, the Preserving Employee Wellness Programs Act (HR 1313), seeks to end that regime for employers that offer wellness programs—despite significant public sentiment that mandatory genetic testing is an unacceptable invasion of privacy.

The law would allow employers to charge workers up to a 30% higher premium if they refuse the testing. That's the same mark-up that employees can be assessed under the Affordable Care Act for not participating in a wellness program if their company offers one.

The bill was passed along party lines by the House Committee on Education and the Workforce. Its momentum has been stalled, though, following strenuous resistance from privacy advocates and the Equal Opportunity Employment Commission, which has consistently taken positions against wellness programs.

In part, objections to the bill have included arguments that the 30% additional premium is so punitive it amounts to coercion to have the genetic testing. Not everyone agrees. "Hey, a choice is a choice," says James Gelfand, senior vice president of health policy for the ERISA Industry Committee, a trade association with about 100 corporate members that lobbies on corporate benefits issues. "You can choose to pay the full premium or you can choose to get a 30% discount."

Genetic-screening firms are trying to convince companies that they could offer the option within their wellness programs without running afoul of existing laws. Still, it's unclear whether even strong participation by employees would actually generate significant savings for health-plan sponsors.

Genetic-screening firms are trying to convince companies that they could offer employees genetic testing without running afoul of existing laws.

"You can't consider only the cost for the one person who had pancreatic cancer and was cured with a straightforward operation, versus the person who had the operation but still ended up incurring hundreds of thousands of dollars in medical expenses before dying," says Levin-Scherz of Willis Towers Watson.

"You also have to think about all the other people who might be found to have the pancreatic gene," and consider their potential medical costs. They would get $1,000 to $2,000 worth of screening every year for the rest of their lives—and some of them might be found to have other conditions that could lead to expensive operations.

Not that there's anything wrong with prioritizing employees' health above additional costs, of course. It's just a matter of understanding all the variables, Levin-Scherz explains.

DIRECT CONNECTION

Retail health-care service providers that market themselves to patients as convenient and typically low-cost are also helping companies control expenses. The providers in this "direct care" model can make it worthwhile for employees to pay out of pocket and bypass insurance. Single episodes of care might be priced at $79 or $99.

Originally focused on the individual market, direct care is gaining traction among self-funded employers and the third-party administrators of their health plans, says Harry Nelson, managing partner at law firm Nelson Hardiman, which has helped multiple health-care providers set up direct-care practices.

Although direct-care services started out offering mainly primary care, employers and TPAs are now contracting for low prices with providers of other services they know they'll need in abundance, such as physical therapy and chiropractic care.

Direct care is different from urgent care, which serves patients who have non-life-threatening conditions that need immediate treatment. "[Direct care enables companies to avoid] specialty costs by creating an earlier pathway to nurses, physical therapists, and chiropractors," Nelson says.

"The likelihood that a wellness program is going to reduce medical costs over the next five years is very low."

—Jeffrey Levin-Scherz, Willis Towers Watson

TPAs, in particular, are driving much of the growth in direct care. While insurance companies themselves offer TPA services, many self-funded companies use stand-alone TPAs. Market leaders include Sedgwick Claims Management Services, Crawford Advisors, York Risk Services Group, Gallagher Bassett, and UMR.

"A few years ago, you didn't hear about TPAs directly contracting with medical providers," Nelson says. But, he adds, they've identified savings and profit opportunities for themselves. Instead of paying in-network rates established by health plans, they're cutting out the middleman and getting lower prices for core medical services.

There's been little coverage of the trend in health-care media, "but it's a source of pricing pressure [on insurers], so I think you're going to see more of it," says Nelson.

ACOs, interpersonal hubs, genetic screening, direct care—in the absence of regulatory and political actions, the market continues to devise new ways of coping with higher employee health-care expenses. It will be up to individual health-plan sponsors, though, to find the strategies that work best for them. CFO

Beware Non-Managing Benefits Managers

To optimize health-plan management, it's often necessary for the CFO to be involved.

CFOs may prefer to leave benefits management to the benefits people, but if they are serious about holding down health-care costs, they might want to keep an eye on those folks.

Consultant Eric Krieg says the first things he looks at when appraising a new client are the priorities of the people assigned to manage the company's health plan. Too often he observes a self-interest on the part of benefits managers that hinders the optimization of plan management.

"They think of something they could do differently, and it seems like a good idea," says Krieg, president of Risk International Benefit Advisors, which mostly serves midsize employers. "But instead of doing it, they manage the outliers. They know that, in response to a change, historically they get beat up by 5% of the [employee] population who are not enthralled with or don't understand the change. So they are very risk-averse."

On top of that skittishness, many benefits managers have little or no upside within their compensation structure as a reward for taking a positive step, Krieg notes. So if a change will create more work or require them to do something differently, they may not be motivated to implement it.

That's why it's important for CFOs to be engaged in health benefits. "When I talk to senior finance people, I want to make sure they're not getting a filtered view of what plan-management options are available," says Krieg.

Finance chiefs also are advised to make sure the company is taking advantage of provisions in contracts with pharmacies and other health-care vendors. "Many of those contracts get stuffed somewhere and nobody looks at them," Krieg says. "You may be able to get more out of those arrangements." D.M.

Opposite, Thinkstock; above, courtesy Willis Towers Watson

Defending The Weak Spots

Businesses must find ways to bolster payments security in order to keep pace with resilient scammers. By Josh Hyatt

59%

Percentage of finance executives who say their companies' fraud assessment and detection strategies will change in the next two years

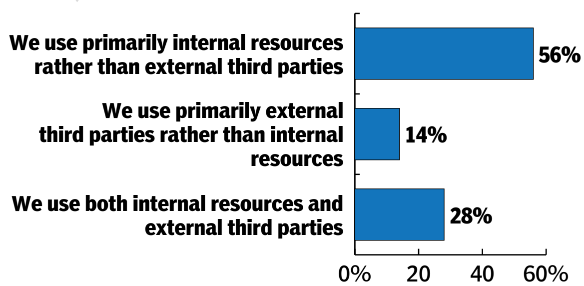
Merchants are engaged in a sustained and intensive campaign against an increasingly sophisticated enemy: fraudsters who are perennially shaping new strategies to exploit the flaws in payment systems. Far from abating, the battle shows signs of consuming more—and more kinds—of resources, including the time of the CFO.

Those were among the findings that emerged from a survey conducted by CFO Research, in collaboration with Vesta, a global provider of electronic payment solutions. Titled "Managing the Risk of Fraud: The View from Corporate Finance," the survey drew responses from 155 U.S. finance executives from a wide variety of industries.

Among survey-takers, 36% report that their company sells only digital goods, such as digital media, etickets, and electronic gift cards. A much lower proportion, 26%, sell only physical goods, including clothing and electronics. A slim majority of the surveyed finance executives, however, classify the businesses they work for as hybrids. Such companies, which comprise 38% of respondents, sell both digital and physical goods.

FIGURE 1

Which of the following statements best describes your company's method for detecting and assessing fraud?



Numbers may not add to 100%, due to rounding

FRAUD FIGHTING

The most visible attempt to mitigate payments fraud in the United States has been the introduction of the EMV (Europay, MasterCard, and Visa) chip card. U.S. merchants faced a deadline of October 2015 for upgrading their systems to accept chip-equipped EMV cards. Those that haven't upgraded are responsible for accepting liability for some types of in-person fraud.

For fraudsters, such a technological overhaul, even one explicitly meant to deter them, merely represents a fresh challenge. Such criminals operate in a dynamic environment, committed to shifting their strategies on-demand so they can penetrate changing defenses.

And while EMV cards have disrupted the world of payments fraud, that disruption is largely just a shift from fraudsters targeting point-of-sale (POS) transactions to targeting card-not-present (CNP) transactions (transactions where the cardholder cannot physically present the card for a merchant's visual examination). The shift means that CFOs see the overall risk from payments fraud increasing rather than subsiding.

In the CFO Research survey, 6 in 10 respondents (62%) say both the number and dollar amount of credit-card chargebacks (credit-card purchases that have been disputed by customers) have increased since 2015. That's a clear indication that fraudsters have in fact adapted, altering their focus from POS transactions at brick-and-mortar stores to CNP transactions on websites. In fact, nearly two-thirds of respondents (64%) have seen both the number and dollar amount of credit-card chargebacks specifically related to CNP transactions increase since the introduction of chip-equipped cards.

INTERNAL AFFAIRS

In many instances, finance teams are responding to the threat by coming up with their own solutions to arrest the rising tide. Among survey-takers, more than half (56%) report using internal

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resources to detect and assess fraud. Just 14% rely primarily on external resources—service providers to which they've outsourced the function—to chase down fraudsters. Twice that number, 28%, classify themselves as hybrids, mixing internal and external resources (see Figure 1). Finance executives typically prefer to rely on an in-house function because of the fixed cost; an outside service provider usually charges on a per-transaction basis.

But the CFO trying to calculate how much to spend to ward off fraudsters also needs to take into account the strategic consequences of payments fraud. More than half (55%) of respondents from companies that use only internal resources to fight fraudsters report that the risk of fraud has interfered with their companies' efforts to develop new products or services or has caused business model changes. A similar number of such companies, 52%, say the risk of fraud has interfered with their companies' budget allocations or revenue projections.

So "penny wise" may indeed be "pound foolish" in fraud fighting.

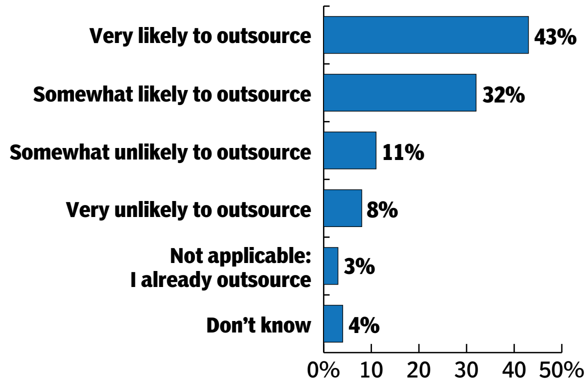
FINDING A BALANCE

Surprisingly, a majority of businesses are open to changing their approach to fighting fraud. In fact, 56% anticipate that their companies' fraud detection and assessment strategies will change in the next two years. Among companies that use only internal resources to detect and assess fraud, the percentage climbs to nearly two-thirds (64%). Such a significant shift suggests that finance executives are looking for a strategy that reduces losses from fraud but doesn't result in inordinately higher operating expenses.

More specifically, 54% of finance executives at companies that use only internal resources say they are "very likely" to outsource some or all fraud detection and assessment activities in the next two years. By using third-party expertise, companies can gain access to top-level data analytics technology as well as other up-to-date anti-fraud controls. Service providers can proactively identify fraudulent patterns, analyzing volumes of data. The move to outsource is seen by respondents as acknowledgment that the risks of a failed effort are so substantial, and the fraud challenges shifting so quickly, that external help may be crucial.

FIGURE 2

How likely are you to outsource some or all of your company's fraud detection and assessment activities in the next two years?



Numbers may not add to 100%, due to rounding

Among all survey-takers, three-quarters say that they are likely (either "very" or "somewhat") to turn to outsourcing in the next two years (see Figure 2). Up to a point, well-conceived and well-run in-house resources can protect a business. But as companies scale, and the magnitude of the threat grows, the risk of fraud can quickly outstrip internal capabilities. Most CFOs truly don't know what they don't know about the state of payments fraud, and uncertainty is never the welcome guest of any CFO.

As the threat of fraud escalates and mutates, finance executives will likely be driven to seek external help in protecting their revenues, reputations, business models, and strategies. Outsourcing may also help CFOs improve the return on their fraud-fighting investment. In the survey, slightly more than three-quarters of respondents (76%) say they regularly measure the effectiveness of in-house fraud management. Better return on investment might result from, for example, reducing "false positives" by using improved processes. Eliminating manual review processes in favor of real-time fraud protection can boost accuracy—which also lifts ROI. For finance executives, the advantages of outsourcing might also include gaining the ability to streamline the in-house team and optimize resource usage, as well as minimizing the potential impact of fraud on areas like employee morale or customer satisfaction.

The speed at which swindlers evolve, and the fierceness with which they attack, require businesses to defend themselves by at least matching their agility. They must out-maneuver the cheats, striving to stay one innovation ahead of them. Payment technology has evolved by focusing on customers—with the mission to minimize friction and boost efficiency leading to a transformation in transactions, as purchases are reduced to gestures like the waving of a smartphone.

But the simpler the transaction appears, the more complex the effort required to deter the fraudsters from posing as legitimate customers. CFOs are in this battle whether they want to be or not. It's clear from the survey that to win they must engage the problem head-on. CFO

THE QUIZ

The Road Forward

Apple, Google, Intel, every major carmaker, and an abundance of startups are pouring money into automating that most American of activities: driving a car. But with the passenger cars sold today projected to last up to 20 years, it will take decades before fully autonomous vehicles pack the highways. How much do you know about advanced automotive technologies? Take our quiz.

1 Which is *not* the name of an existing self-driving car business or company?

A. Waymo
B. Apex
C. Faraday Future
D. Argo

2 What percentage of U.S. consumers feel that fully autonomous vehicles will not be safe?

A. 74%
B. 62%
C. 35%
D. 52%

3 The perceived convenience of autonomous vehicles is expected to make them popular, and therefore increase overall vehicle travel. By 2035, autonomous vehicles are likely to increase total vehicle travel by:

A. As much as 15%
B. As much as 9%
C. As much as 3%
D. Less than 1%

4 Which of the following is *not* one of U.S. consumers' top-ten most preferred advanced automotive technologies?

A. Car recognizes objects on road and avoids collision
B. Car takes steps in a medical emergency or accident
C. Car diagnoses and sends maintenance notifications
D. Use of smartphone applications through the dashboard

5 What is the overall average price that U.S. consumers are willing to pay for advanced automotive technologies, like connectivity tools and self-driving capabilities?

A. $700
B. $2,000
C. $925
D. $1,300

6 As per-capita incomes rise in emerging markets, they will account for an ever-growing share of the world's new car purchases. How many vehicles does Goldman Sachs predict will be sold in emerging markets in 2025?

A. 34 million
B. 50 million
C. 52 million
D. 78 million

Answers: 1–B; 2–A; 3–B; 4–D; 5–C; 6–D

Sources: Deloitte Global Automotive Consumer Study; Victoria Transport Policy Institute; Goldman Sachs "Cars 2025" study

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